SUPERVISION REPORT

2023

BANCO DE ESPAÑA
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SUPERVISION REPORT

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Presentation by the Governor Pablo Hernández de Cos

Supervisory activity in 2023 was influenced by exogenous shocks, in particular those stemming from geopolitical tensions, by monetary policy tightening, which materialised in sharp interest rate hikes in several monetary areas, and by the global banking turmoil experienced in March.

After more than a decade in which interest rates were very low (and even negative), the monetary policy shift following the surge in inflation, combined with the energy crisis, had a significant impact on economic activity across Europe. However, the Spanish economy – and especially the labour market – retained considerable momentum.

In consequence, Spanish banks were able to achieve strong profit growth which, albeit unevenly across banks, allowed the sector as a whole to exceed its cost of capital. However, this has only led to a modest boost to solvency.

From a medium-term perspective, a call for prudent behaviour from banks is needed, especially in a setting in which, although the economic growth outlook continues favourable, significant risks remain, in particular from global geopolitical tensions.

To begin with, the net interest income growth observed in recent years cannot be considered permanent. Following the rapid pass-through to income of the interest rate rises, the cost of deposits is expected to increase, in a setting in which, so far, there has been only a partial pass-through to deposits owing to high levels of liquidity. Moreover, banks should be prepared for a possible deterioration of credit portfolios as creditors face higher debt servicing costs. This deterioration generally appears with a certain time lag compared with the immediacy of the repricing of floating rate loans.

Against this backdrop, banks should make careful provisioning and capital planning and take advantage of rising profits to increase their solvency levels and fund their strategies to respond to structural banking sector challenges, such as the digital transformation, growing competition from fintechs and the shift towards more sustainable business models.

Moreover, in the field of bank conduct and transparency with customers, and in the setting described, marked by rising inflation and interest rates, in 2023 the Banco de España's supervisory activities focused, in particular, on operations with the most vulnerable customers and on the control measures adopted by banks to address the risks of card fraud and digital payment fraud. These actions allowed us to identify certain weaknesses, along with various trends and best market practices. By correcting these weaknesses and extending best market practices, banks should be able to improve their customer relationships.

Looking ahead, we will continue to foster a preventive supervisory approach, based on early risk identification, and we will continue to take steps to provide greater transparency on supervisory priorities and expectations. This process will be underpinned by the findings of the ongoing external evaluation of our supervisory approach in this area and the corresponding action plan, which we will publish in the coming months.

From a global perspective, in March 2023 the international banking system experienced the most significant stress episode since the global financial crisis. The turmoil affected a number of banks from different countries, mainly the United States and Switzerland.

Stability was returned to the banking system thanks to a combination of public support measures – such as central bank liquidity facilities for banks, public guarantees or even the broadening of deposit guarantee schemes – in the jurisdictions involved. Meanwhile, the greater resilience provided by the regulatory reforms of the last decade, and in particular by the implementation of Basel III, reduced the risks of contagion to the rest of the global banking sector.

On the Financial Stability Committee and the Basel Committee on Banking Supervision (BCBS) we analysed this situation to try to understand its scope and implications and draw conclusions. One of the main lessons learned, and on which there is broad consensus, is the importance of banks' sound risk management practices and governance arrangements as the first and most important source of financial and operational resilience. In addition, this first safeguard, which necessarily falls on banks themselves, must be accompanied by robust regulation and strong and effective supervision on a global scale. In this respect, supervision should be sufficiently flexible and geared towards the principal risks at any point in time.

In the regulatory field, fully implementing Basel III (including the last package of reforms endorsed in 2017) across jurisdictions and as soon as possible remains a key priority. This has been my main objective throughout my years as Chair of the BCBS and I want to reiterate it once again in the final stretch of my term. Robust common minimum regulatory and supervisory standards are crucial to safeguard financial stability worldwide.

In the European Union (EU), the transposition of Basel III began just over ten years ago with Regulation (EU) No 575/2013 and Directive 2013/36/EU on prudential requirements for credit institutions. These rules also provided for more harmonised prudential regulations within the EU, laying the foundations for the European Single Rulebook applicable to all EU banks.

As this process of building the banking union continues, in November 2024 we will celebrate the 10th anniversary of the entry into operation of the Single Supervisory Mechanism (SSM). The launch of the SSM posed a major challenge and the Banco de España made a decisive contribution. The new supervisor drew on best practice from the European Central Bank (ECB) and the participating national authorities. This involved significant cultural changes in many aspects and has resulted in a robust, credible, flexible and globally influential supervisory body.

In this regard, further deepening of the banking union is needed, to ease the vulnerabilities and fragmentation of the European financial system. The next big step should be the creation of a fully mutualised European deposit guarantee scheme, boosting public and market confidence.

Staying with European concerns, in 2023 the ECB agreed to continue the work on the digital euro project, ushering in a new phase that aims to lay the foundations for its potential use. Moreover, the European Commission adopted a legislative proposal to grant the project an appropriate regulatory framework. However, none of the work completed or agreed so far involves a decision to issue the digital euro. Should the ECB eventually decide to do so, the digital currency would be distributed by regulated payment providers. Although European – and especially Spanish – payment systems are currently highly efficient, the speed at which digitalisation is advancing clearly justifies the efforts and resources dedicated to this project.

To conclude, the progress made in this decade means that, from the supervisory perspective, we face the future with confidence in the robustness of the system, but without growing complacent. The European banking system is now stronger and more resilient to shocks. It also has a more integrated supervisory framework, equipped with new tools, and a robust and unified regulatory framework. This places the financial sector and the supervisory bodies in a better position to address the important challenges facing the European economy in general and the banking sector in particular.

Pablo Hernández de Cos

Governor of the Banco de España

Interview with the Deputy Governor Margarita Delgado Tejero

November 2024 will mark the tenth anniversary of the launch of the Single Supervisory Mechanism (SSM), a major European initiative to which the Banco de España made a decisive contribution. What is your assessment of the last decade and what are the main challenges that still remain?

There is no doubt that setting up the SSM was a major challenge, especially given the time pressure and the difficult economic and financial context. Despite the intense work, I would highlight the enthusiasm and confidence we felt in that first phase and how much we achieved in a short space of time. Since then, the SSM has made steady progress towards becoming the robust, credible, flexible and internationally respected supervisor that it is today. However, although there have been many achievements over this decade, we must not become complacent, especially in a different economic, technological and geopolitical environment to that of ten years ago.

We need to further enhance the following: effectiveness, by deepening the risk-sensitivity of supervision; efficiency, with clear support for SupTech tools and streamlining procedures and methodologies; flexibility, to respond swiftly to an increasingly dynamic environment; consistency of supervisory practices; and organisational integration.

In this ever-changing scenario, what will be the main focal points of supervisory activity in the coming years?

It is precisely this environment of high uncertainty and complexity that has focused our attention on institutions' ability to withstand the potential consequences of geopolitical turmoil and other macro-financial shocks. The management of credit risks, including counterparty risk, as well as liquidity and interest rate risk, is key, as we saw in the US banking crises of spring 2023.

On the one hand, we had unprecedented interest rate rises that benefited banks and, on the other hand, the European Central Bank has started to gradually withdraw its expansionary measures. This new paradigm has consequences that need to be analysed and managed. I am referring both to the impact of interest rate rises on the cost of financing companies and households and, consequently, on their payment capacity, and to the need for institutions to have robust funding plans, with diversified sources that can withstand any short-term liquidity shocks.

We have also identified as priorities other structural challenges that institutions must deal with in the medium term, such as the need to remedy shortcomings in governance and in climate and environmental risk management, as well as challenges posed by digital transformation for business models and institutions' operational resilience and adaptation to technological risk. To this end, we have already launched a series of supervisory activities for this year.

You referred to the US banking crises last spring. What conclusions should we draw from this turmoil, and from the turmoil at Credit Suisse?

To put it very briefly, we must conclude that the crises were the result, in the first place, of inadequate governance and poor risk management and control. Imbalances in the balance sheet structure, with high concentrations in certain types of assets and liabilities, as well as exponential balance sheet growth, led these banks to assume very high interest rate and liquidity risks, which eventually materialised as a result of monetary policy changes in the United States. In other words, unsustainable business models.

Secondly, there were also clear shortcomings in the supervision of these institutions. On the one hand, the complex supervisory framework in the US, with several supervisory authorities, did not help. And on the other, supervisors did not act swiftly enough in relation to the shortcomings detected, because of slow internal decision-making processes and the absence of sufficiently effective supervisory measures.

Thirdly, we also have to mention regulation. It should be recalled that US medium-sized institutions are not subject to the much stricter Basel standards to which all the European Union (EU) institutions are subject.

The case of Credit Suisse was a result of a general market reaction to the crises of the US banks, which indicated a lack of confidence in its business adjustment strategies. Once again, this highlights the importance of analysing the viability and sustainability of business models.

Speaking of business models, we have seen a huge recovery this year in the profitability of European banks in general, and Spanish banks in particular. To what extent do you think these increases are sustainable?

The increase is explained by the improvement in net interest income, with the rise in financial revenues far outstripping financial costs. We should remember that banks were starting from an environment where interest rates, which, if I may say so, are the “raw material” of the sector, had been zero or negative for more than ten years. This affected banks and meant they had to strive to become more efficient in operational costs and remain profitable during this time.

The current context of positive rates, which is the natural context, has had a very favourable effect on income statements. But I want to be cautious, as such a significant increase in net interest income cannot be considered sustainable. Firstly, the transfer of the rise in interest rates to loan portfolios is almost complete; even some of the loans that will be repriced in the first quarter of 2024 will be at lower rates. Secondly, lending volumes continued to fall in 2023, which will also affect future margins. In addition, the cost of funding may increase as the tightening of monetary policy continues to permeate. And, lastly, we are already seeing some signs of rising NPLs in some portfolios. Added to this, geopolitical conflicts further compound uncertainty, and the economic outlook remains poor in Europe.

For all these reasons and, despite the fact that, in the stress tests carried out in 2023, Spanish institutions showed satisfactory levels of capital in the adverse scenario, which was more severe than in previous tests, I would like to repeat the message I have already delivered on other occasions: it is essential that institutions have robust provisioning and capital planning policies. This is necessary to continue to operate soundly in a changing environment and to face the structural challenges of digitalisation and transformation to a more sustainable economy.

You mentioned earlier that the review of technology risk is one of the supervisory priorities. How does the review of this risk materialise?

Indeed, the importance of technology risk has grown in recent years as institutions have become increasingly digitalised. When we talk about technology risk, we are not only referring to cyber attacks, which are potentially relevant in the current geopolitical context, but also to all incidents that might affect the infrastructures of digital processes, with critical consequences.

Institutions should be prepared to detect and remedy system failures caused by cyber incidents in the shortest possible time. It is not just a question of putting up barriers, but also having procedures in place to mitigate the consequences of incidents on operational processes.

To this end, we have two groups of experts at the Banco de España: one is responsible for on-site inspections and the other for more cross-institutional matters such as conducting cybersecurity stress tests, participating in international working groups and supporting the entire Directorate General on these issues.

This is undoubtedly an area of growing significance as a result of the new supervisory powers on this matter arising from new European regulations.

How does the digitalisation process you mentioned affect business models?

Digital transition is affecting our economy across the board and banking is no stranger to this phenomenon.

Banks' business models have been greatly affected by this digitalisation process: in the area of banking and payments, new technologies are changing the financial services sector, allowing it to become more competitive and efficient. However, the process is not risk-free, so it is essential that banks establish an operational risk framework that addresses issues such as increasingly sophisticated and damaging cyber attacks, dependence on external providers, etc.

In this regard, as part of its digital finance strategy, the EU is equipping itself with a regulatory framework to ensure stability and consumer protection. Two important regulations were published in 2023: the crypto-asset markets regulation, MiCA, and the digital operational resilience act, DORA.

DORA governs requirements on technology risk management (paying special attention to governance), incident reporting and resilience testing similar to the tests we already have in Spain under the TIBER framework.

However, the most distinctive feature of DORA, the one that has made it a global benchmark, is the oversight framework of critical technology providers for the European financial sector as a whole.

Lastly, I would also like to highlight the fact that digitalisation also affects us supervisors. On the one hand, we must have an in-depth understanding of the technological tools that institutions use and the risks associated with them — for example, in the use of machine learning. On the other hand, we also make use of innovative technologies to support our work, known as SupTech, developed either in-house or in collaboration with SSM initiatives.

I would like to raise a topical issue: the risk of money laundering and financing of terrorism (AML/CFT), the latest approved regulation and, of course, the new European authority for the prevention of these matters.

The institutional architecture in Spain is clear and the powers assigned to us at the Banco de España in this area are limited to the supervision of certain obligations of the institutions under our supervision. This supervision is carried out in close cooperation with the Commission for the Prevention of Money Laundering and Monetary Offences and its Executive Service, SEPBLAC, and with the National Securities Market Commission and the Directorate General of Insurance and Pension Funds. For example, as well as coordinating the planning of the year's activities with the other authorities, in 2023 we cooperated with SEPBLAC in updating the AML/CFT risk assessment methodology.

However, at the moment, what is perhaps most noteworthy in this area stems from the strong European impetus initiated in 2020 with the European Commission's action plan. This plan involves, inter alia, two key milestones. On the one hand, the establishment of a single rulebook, which, following the agreement of the Council and the European Parliament in January this year, is now close to publication. On the other hand, the creation of a European authority, the Anti-Money Laundering and Countering the Financing of Terrorism Authority (AMLA), which will have direct and indirect supervisory powers over high-risk regulated institutions in the financial sector. The experience accumulated both by the institutions and by the Banco de España in the ten years of the SSM and the demanding Spanish AML/CFT regulatory framework represent strengths in this transition to a new regulatory framework and a single supervisor at the European level.

The Banco de España has a wide range of macroprudential tools at its disposal: buffers, sectoral tools and limits on lending criteria. What can you tell us about this?

Macroprudential policy has become a significant instrument to mitigate the build-up of systemic risk, which could harm the financial system and lead to disruptions in the provision of financial services, with serious negative effects on the economy. In 2023, the Banco de España applied the revised methodology for calibrating the buffers of other systemically important institutions for the first time, which led to the increase in the buffer required for 2024 for the two largest institutions out of the four identified. The other macroprudential measures were not activated.

The commercial real estate sector in Europe has been closely monitored by both the micro- and macro-supervisor. In 2021 the SSM was already prioritising the review of this sector and at the end of 2022 the European Systemic Risk Board issued a recommendation linked to vulnerabilities in this sector, which, among other issues, called on the competent authorities in the area of financial stability to closely oversee current and emerging vulnerabilities related to commercial real estate. In 2023, the Banco de España agreed to comply with this recommendation. However, I would like to stress that exposure to this sector is relatively low in Spain.

Conduct supervision has been in place for years. Which issues and actions would you highlight?

That is indeed the case. Having grown in importance for years, in 2022 the Law on the regulation, supervision and solvency of credit institutions was amended to expressly introduce the duty of institutions to act in an honest, impartial, transparent and professional manner, with respect for the rights and interests of customers.

The Banco de España's strategy in this area revolves around two central factors: the definition of priorities based on conduct risks and the preventive approach to supervision. In the current context, the proper marketing of products and services —including most notably consumer credit— and compliance with measures aimed at groups facing difficulties —especially the Code of Good Practices (revised in 2023)— are particularly important. In addition to these priorities, there are the now traditional actions in relation to advertising information and customer service departments.

Also, we have an increasingly comprehensive regulatory framework, as shown, for example, by the Banco de España's recent publication of the *Guidelines on the governance and transparency of revolving credit.*

Lastly, I would like you to share your thoughts on the role of the Basel III regulation over the last decade.

As I have already mentioned, I believe the European institutions were in a strong position to weather the successive crises of the last four years, including last spring's turmoil. And this is due in part to the Basel III regulation. The reforms already implemented have shown its robustness from multiple angles, helping protect the international banking system and the real economy from a more severe banking crisis. Thus, the lessons learned do not point to the need for a drastic change in the current regulatory framework, although there are issues that merit further reflection.

The Basel Committee on Banking Supervision has recalled the importance of full and consistent implementation of the framework as soon as possible, a view I fully share. The EU is now in the process of incorporating the last phase of Basel III, which is scheduled to enter into force in 2025. Adoption is, in general, complete and faithful to the international framework, although some options are exercised and certain particularities are introduced. Some of the most significant amendments it includes have been long awaited, such as the establishment of the output floor for the outcome of models. The full implementation of Basel III will undoubtedly be a milestone in international financial regulation.

Supervision Report: Digest

CHAPTER 1.	SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA
Supervisory functions of the Banco de España	• The Banco de España has various supervisory powers over credit institutions and over other financial institutions or undertakings related to the financial system operating in Spain. • Microprudential supervision, which is exercised within the framework of the Single Supervisory Mechanism (SSM), aims to ensure the solvency, liquidity, sound functioning and prudential regulation compliance of credit institutions and other institutions in the financial system. • The purpose of macroprudential policy is to safeguard financial stability, through the use of macroprudential instruments, to prevent and mitigate systemic risks and vulnerabilities. • The supervision of the conduct, transparency and customer protection of the institutions registered in its official registers, as well as the verification of effective compliance with the rules, seeks to further strengthen institutions' culture towards a responsible banking model, in order to guarantee an appropriate financial relationship with their customers. • The supervision of the provision of payment services aims to safeguard security in payment service provision and promote an integrated, secure and efficient payments market. In addition, the Banco de España also carries out the oversight of payment systems and instruments to promote their proper functioning, and shares with the National Securities Market Commission (CNMV) the oversight of securities infrastructures. • Lastly, the Banco de España cooperates with the Commission for the Prevention of Money Laundering and Monetary Offences and its Executive Service (SEPBLAC) in the area of anti-money laundering and countering the financing of terrorism (AML/CFT).
Supervisory and oversight staff	• At 31 December 2023, the Banco de España had 894 employees performing supervisory and oversight functions, as compared to 849 employees at 2022 year-end (+5%). Of these, 47.9% are men and 52.1% are women, although the distribution varies among the professional groups.

CHAPTER 2.	MICROPRUDENTIAL SUPERVISION
The Spanish banking sector	• In 2023, the total consolidated credit balance of Spanish credit institutions decreased due to the significant contraction of operations in Spain in all segments and the decrease in cash balances at central banks and in demand deposits at other credit institutions. There was no significant deterioration in credit quality indicators, and the NPL ratio remained at similar levels to 2022 year-end, albeit with slight upturns in NPLs in the consumer and mortgage segments. • Following the decline in 2022, liquidity coverage ratios (LCR) have remained stable with comfortable levels in 2023, in a context of early and ordinary TLTRO III (Targeted Longer-Term Refinancing Operations III) repayments and lower credit demand. • Institutions continue to show increasing levels of profitability. The evolution of interest rates has driven the growth of net interest income during 2023. In addition, the improvement in operating profit that exceeded the increase in overhead costs led to a favourable performance of the efficiency ratio. • Solvency levels remain at record highs (16.9% of total capital at September 2023, with an average of 16.6% for SIs and 20.4% for LSIs). • In short, the impact of the pandemic has been overcome, with higher levels of profitability and solvency, but signs of a slowdown in financial activity are beginning to emerge, calling for caution. In view of the situation of uncertainty, it would be desirable for institutions to take advantage of this current favourable moment and apply prudent policies in their capital planning and returns and in their credit risk coverage.
Supervisory priorities in 2024 for credit institutions and focal points	• The European Central Bank (ECB) set the priorities for significant institutions (SIs) for 2024-2026 around three major objectives: i) increase resilience to macro-financial and geopolitical shocks and, to this end, continue to strengthen credit risk management and funding and interest rate risk management; ii) accelerate the effective remediation of shortcomings in governance and in the management of climate-related and environmental risks; and iii) further progress in digital transformation and building robust operational resilience frameworks. • In line with the above, the Banco de España has identified as a priority for less significant institutions (LSIs) in 2024 the treatment of credit risk, liquidity and IRRBB risk policies and procedures, internal governance, climate risk management, business models and sustainability, and operational risk (in particular, technology risk). • The supervisory focal points for SIs in 2023 were grouped into three broad areas: i) increasing resilience to macro-financial and geopolitical shocks; ii) addressing institutions' structural vulnerabilities (regarding governance, technology risk and digital transformation); and iii) continuing to adapt the business strategy and risk management framework to climate risk. For LSIs, work was focused on credit risk management, business models and sustainability, operational risk (in particular, technology risk), governance, capital planning, and risks linked to climate change.

Supervision of credit institutions

- Noteworthy among the recurrent ongoing off-site supervision tasks are those related to the SREP, which include most notably the requirements and recommendations related to capital, credit risk and governance. In addition, other actions are worthy of note due to the resources devoted and/or conclusions reached, such as in-depth reviews on NPLs and cross-institutional reviews of residential real estate financing, IFRS 9 provisioning models, digitisation or Pillar 3 disclosures on climate risk.
- A total of 19 on-site inspections were launched at Spanish SIs, focusing on credit risk (6 inspections), business model (3) and technology risk (2). Credit risk and interest rate and market risk inspections account for the bulk of findings. Also, 11 model investigations were conducted, all on credit risk, and most of them were focused on reviewing material changes to models to adapt to the new EBA guidelines.
- The SREP is also one of the central tasks in the ongoing supervision of Spanish LSIs. In addition, various actions were carried out, including most notably horizontal reviews on technology risk and climate risk. Overall, for LSIs and the ICO, 727 ongoing supervision actions were carried out during 2023. In addition, 11 on-site inspections were completed, with a special emphasis on the assessment of credit quality and foreclosed assets, governance and solvency, along with IT-related matters.
- As a result of the supervisory actions described for LSIs and the ICO, the Banco de España sent a total of 93 letters with 508 requirements or recommendations, mostly Pillar 2 requirements included in capital decisions, followed by governance, business model and operational requirements and recommendations.
- In 2023, Spanish SIs participated in the European stress tests. The results showed that Spanish SIs would have satisfactory capital levels in the adverse scenario. In turn, the Banco de España conducts annual stress tests on LSIs in the same framework and under the Forward Looking Exercise on Spanish Banks (FLESB) tool. The results showed that the aggregate solvency of all the LSIs in both scenarios would be high, above regulatory requirements.
- In December 2023, 19 Spanish credit institutions had issued covered bonds, with a total of 27 authorised programmes. In 2023, both individual monitoring of each of the issuing institutions and a horizontal analysis were carried out. Both the issuers and control bodies have adequately adapted to the new regime. In addition, in 2023 the Banco de España assumed the supervision of the specific framework for simple, transparent and standardised (STS) securitisations, provided for in Regulation (EU) 2017/2402, when the issuers of these instruments are credit institutions or other institutions under the supervision of the Banco de España.
- In relation to anti-money laundering and countering the financing of terrorism, in the course of 2023 the Banco de España completed the following inspections (all of which were commenced in 2022): 2 general actions, 1 specific inspection on internal control systems and, jointly with SEPBLAC, 15 thematic reviews of foreign exchange activity. Also, it commenced and concluded 4 inspections at currency-exchange bureaux.

Supervision of institutions other than credit institutions, of payment service provision and of compliance with vetted access to activity

- The Banco de España has exclusive microprudential supervisory powers over institutions other than credit institutions, on which 281 ongoing off-site supervisory actions were carried out in 2023 by various means; also, it commenced 3 inspections and a multitude of other supervisory procedures.
- In the 2023 supervision of payment service provision, a major part of the work was focused on reviewing compliance by payment institutions and electronic money institutions with the guarantee and protection requirements for payment service users' funds. Moreover, the analysis of the evolution of fraud data seems to confirm the growing impact and importance of digital fraud with respect to total fraud in payment transactions, especially in transfer and card transactions. Also, in 2023 there was a significant increase in communications related to the outsourcing of important operational functions.
- The Banco de España, as the body responsible for overseeing compliance with vetted access to activity, initiated 15 supervisory actions in 2023 (14 against legal entities and 1 against an individual that may have been carrying out restricted activities or making undue use of an unauthorised name). In the area of payment services, analyses of 8 potential cases of non-compliance with vetted access to activity commenced in 2023.

Application of financial technology innovation to supervisory functions (SupTech). The sandbox: controlled digital innovation testing space

- The roadmap until the end of 2024 to incorporate the use of innovative technology into the supervisory area (SupTech) presents 4 lines of work: i) in-house creation of SupTech tools; ii) active participation in SSM initiatives in this area; iii) fostering a culture of innovation; and iv) promotion of training in data science. The results of the external assessment of the SupTech function have already been published, highlighting strengths and possible areas for improvement in this area.
- In 2023 there were two new calls for applications to the controlled testing space, known internationally as the sandbox. Throughout 2023, projects from five different calls coexisted. There are various different types of promoter, including both supervised and non-supervised institutions, most notably consultancy firms, FinTechs and banks. None of the projects tested, from the launch of the sandbox to date, is applicable to the better performance of supervisory functions. The authorities responsible for the sandbox continue to work on improving its functioning.

Boxes

- In just ten years, the SSM has become a robust, credible, adaptable and internationally respected banking supervisor. However, further improvement is required and the challenges ahead will need to be addressed with ambition. Future challenges include the following: to increase effectiveness, by enhancing the risk approach and the focus on results; to improve consistency; and to increase efficiency, by using SupTech tools and leaving more room for supervisory judgement. In any case, the supervision of the future will need to have the necessary flexibility to respond to an increasingly dynamic environment.
- In the crisis that hit several US regional banks and Switzerland's Credit Suisse in the first half of 2023, deposit withdrawals and liquidity pressures forced the intervention of supervisory and resolution authorities to safeguard the stability of the banking system. This crisis offers valuable lessons for the supervisory approach; of particular note is the importance of a holistic analysis of business models and of paying attention to asset and liability management and the need to act swiftly to remedy detected shortcomings, with the focus on the effectiveness of supervisory measures.
- Effective supervision should ensure that institutions have adequate capital and liquidity and that indicators of key risks are kept at manageable levels. In recent years, developments in the banking sector in Spain and in Europe have, on the whole, been very favourable, helped by supervisory activity under the SSM framework, which is more demanding and seeks a more prominent impact. The effectiveness of supervisory action is linked to the selection of an appropriate combination of supervisory measures, with an ambitious use of qualitative measures and efforts to communicate with institutions. This increased level of scrutiny has led to progress by institutions, although not with the same intensity and pace for all risks.
- Climate and environmental risks have been among the supervisory priorities in recent years and have required supervisors to play an active role, with supervisory activities, dialogue with institutions and publication of observed good practices. Also, it is important to note the significance of transition plans, which must necessarily be based on the plans produced by their main counterparties.
- The Digital Operational Resilience Act (DORA) was published in December 2023, and its date of application is January 2025. The feature that makes it a global benchmark is the establishment of an oversight framework for critical technology suppliers. The implementation of this oversight mechanism will require a significant effort by all financial sector authorities to develop procedures and methodologies in order to carry out the effective supervision of large and complex companies and to equip themselves with the necessary additional resources.
- There has been a growing use of machine learning techniques for credit risk measurement and management. In authorising the use of these techniques in internal ratings-based models, the supervisor is faced with the difficulty in interpreting and explaining the models' results. They are also generating interest in the area of loan origination, due to the increased predictive capacity; however, such uses will be subject to a specific regulatory framework, which is currently pending approval, and will be subject to the requirements set out in the General Data Protection Regulation.
- One of the pillars of the Banco de España's drive for technological innovation is the in-house development of SupTech tools. Four lines of work can be distinguished in this development: i) improvement of the quality of the Central Credit Register (CIRBE); ii) detection of changes in trends and anomalous data based on machine learning algorithms; iii) graphical representation of large amounts of data to facilitate their interpretation and analysis; and iv) exploration of predictive capacity based on CIRBE information and exploitation of information from unstructured texts.
- The EU plans to create the new AML/CFT authority —AMLA— and to strengthen legislation with a new directive and a regulation. The Banco de España will actively contribute to the articulation and coordination of AML/CFT supervision by AMLA, building on the experience gained over the Single Supervisory Mechanism's ten years of existence.

CHAPTER 3. MACROPRUDENTIAL POLICY

Banco de España's macroprudential policy tools	• Under current legislation, the Banco de España can set macroprudential capital buffers to address the build-up of systemic risks. • In 2023, the Banco de España maintained the countercyclical capital buffer (CCyB) at 0% for credit exposures in Spain: it considered it to be an appropriate macroprudential policy response given the absence of imbalances in Spain's credit cycle, in an environment characterised by geopolitical tensions, high inflation rates and the tightening of the ECB's monetary policy. • In 2023, one global systemically important institution (G-SII) —which is also a domestic systemically important institution (O-SII)— and three other O-SIIs were identified, and their associated capital buffers were set for 2024 (O-SIIs) and 2025 (G-SII). • The Banco de España modified its methodology for determining O-SII capital buffers to adapt it to the ECB's new revised minimum buffer framework. This change brought about an increase of 0.25 pp in 2023 in the O-SII buffers applicable in 2024 for two institutions.
Macroprudential coordination at the national level	• The Banco de España is one of the member institutions of the Spanish macroprudential authority (AMCESFI), which is attached to the Ministry of Economy, Trade and Business and in which the CNMV and the Directorate General of Insurance and Pension Funds also participate.
Macroprudential tasks at the European level	• The Banco de España participates in the Financial Stability Board and the ECB's Macroprudential Forum. As an SSM member, it notifies the ECB of all its proposals for macroprudential measures prior to their adoption and announcement.

CHAPTER 4. SUPERVISION OF INSTITUTIONS' CONDUCT

Objectives	• Beyond the verification of compliance with applicable regulations, the fundamental objective of conduct supervision is to foster a culture of compliance at institutions, aimed at establishing business models and organisational structures that ensure sound market practices, with particular attention to institutions' customer relations. • Supervisory attention is focused on assessing the institution's internal control framework, thereby helping strengthen the conduct of supervised institutions and identify best market practices. In doing so, the principle of proportionality is applied. Also, the exchange of information and the transmission of relevant messages to institutions is fostered, including, among other aspects, the communication of supervisory priorities and expectations.
Supervisory activity	• Ongoing monitoring allows potential conduct risks to be anticipated and contributes to the design of the supervisory strategy and to the planning of supervisory actions. Also, the interaction with institutions allowed them to modify certain aspects proactively and prior to the adoption of supervisory measures, which confirms the effectiveness of collaborative mechanisms between supervisor and institutions. • A number of supervisory actions were carried out in 2023 in areas such as consumer credit (point-of-sale deferred payment solutions, tacit overdrafts and responsible lending), basic payment accounts and alleviation measures for groups facing difficulties. • Supervisory activity, supported by an increasingly developed and comprehensive regulation, has helped strengthen the culture of conduct compliance.
Supervisory measures	• As a result of the corresponding supervisory actions, the following measures were adopted in 2023: 1 sanctioning proceeding initiated, 57 advertising requirements, 44 requirements on other matters and 76 recommendations and clarifications. Institutions' compliance with the supervisory measures adopted is positively assessed.

CHAPTER 5. OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Oversight of payment systems and instruments	• The Banco de España, together with the Eurosystem, completed the oversight of the T2-T2S consolidation project, which culminated on 20 March 2023 with the successful implementation of the new TARGET system, comprising the T2, T2S and TIPS settlement services. • The Sistema de Tarjetas y Medios de Pago (STMP), which is responsible for clearing the bulk of card transactions at the national level, was identified as a prominently important retail payment system and is subject to the Eurosystem's oversight framework. As regards Redsys and Cecabank, they became monitored by the Banco de España as providers of critical STMP services, since they execute the processes of calculating the net interbank obligations (clearing) resulting from these retail operations. • Instant transfers represented over 52% of total transfers in Spain, while in the European Union they accounted for just over 15%, according to statistics from the second quarter of 2023. • In relation to the Eurosystem oversight framework for electronic payment instruments, schemes and arrangements (the PISA framework), the Banco de España participated in the assessment of the set of schemes operated by the European Payments Council (EPC), in particular the SEPA direct debit and credit transfer schemes.
Supervision of Iberpay (management company of the National Electronic Clearing System)	• The Banco de España approved a new SNCE regulation. In addition, it assessed 11 operating instructions of the SNCE, which the Banco de España did not oppose. These include issues such as the adaptation of the subsystems' rules to the new regulation, the incorporation of the responsibilities of the participants in the transfer subsystems in relation to recall requests due to fraud, the finalisation of the project involving the replacement of the physical exchange of documents by the exchange of images, the incorporation into the regulations of each subsystem of the relevant sectoral agreements on responsibilities between institutions, and the adaptation of the instant SEPA transfer subsystem rules to the new version of the EPC's SEPA Instant Credit Transfer Rulebook.
Oversight of securities infrastructures	• With respect to T2S, monitoring continued on the implementation of recommendations as a result of the assessment of compliance with the principles for financial market infrastructures issued jointly by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, and on the assessment of the penalty mechanism for delays in the matching and settlement of instructions required by the Regulation on improving securities settlement and on central securities depositories. • In relation to BME Clearing, the Banco de España issued six mandatory reports in accordance with Articles 86.4 and 94 of the Securities Markets and Investment Services Law —all of them favourable— related, inter alia, to adaptations to Regulation (EU) 23/2021 on a framework for the recovery and resolution of central counterparties, and to the opening of a new digital asset segment.

CHAPTER 6. EXERCISE OF SANCTIONING POWERS

Penalties	• Sanctioning powers, as a necessary supplement to the supervisory function, continued to be exercised in 2023. The largest number of sanctioning proceedings were concentrated in the prudential area, notably those relating to internal control, risk management and governance, and the maintenance of sufficient capital. The sanctioning proceedings relating to transparency and customer protection were due to shortcomings in the offer and marketing of credit cards, in the accrual of interest, in the charge and settlement of interest and fees, and in pre-contractual and contractual information, among others.

CHAPTER 7. THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

Global fora	• During 2023, the Financial Stability Board further elaborated on resolution-related issues, with the review of the banking turmoil at the beginning of the year from this perspective and the publication of a framework for the resolution of central counterparties. Also, it continued to work on strengthening the non-bank financial intermediation sector, analysing vulnerabilities associated with structural changes (in particular vulnerabilities related to crypto-assets, climate change, cyber incidents and risks linked to the services of external providers) and improving cross-border payments. • The Basel Committee on Banking Supervision —chaired by the Governor of the Banco de España— made progress on its work on the digitalisation of finance, developed a Pillar 3 proposal as part of its holistic approach to address the financial risks arising from climate change, revised the Core Principles for Effective Banking Supervision and continued to promote the full, consistent and timely application of the Basel framework. In relation to the March 2023 episodes, the Committee published a report with regulatory and supervisory analysis and lessons.
European fora	• In 2023, the European Banking Authority worked actively to ensure an effective and consistent level of prudential regulation and supervision; to this end it prepared a significant number of technical standards, guidelines and reports. Also, as a consequence of the turmoil in March, it intensified the assessment of risks and vulnerabilities in the European banking sector. In July it published the results of its analysis of unrealised losses in European banks' fixed income portfolios, which concluded that they were contained. • The European Systemic Risk Board —whose Advisory Technical Committee has been chaired by Pablo Hernández de Cos since 2019— focused its work on the analysis of issues of relevance to financial stability, such as cyber resilience, financial innovation and the situation of the real estate market. • The Banco de España is a member of the Governing Council of the International Financial Consumer Protection Organisation, of the Committee on Payments and Market Infrastructures of the Bank for International Settlements and of the Network for Greening the Financial System.

CHAPTER 8. NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

Banco de España's new regulatory developments	• In 2023 the Banco de España published three circulars on the following subjects: i) new reporting obligations to the Banco de España on covered bonds and other loan mobilisation instruments (Circular 1/2023); ii) amendments to the reporting obligations to the Banco de España's Central Credit Register (Circular 2/2023); and iii) ban on collecting deposits under the regime for the provision of services without a branch by third country credit institutions and review of the information to be reported on remuneration (Circular 3/2023). In addition, guidelines on the governance and transparency of revolving credit were published, which include best practices as well as criteria and procedures considered adequate for regulatory compliance. • There are four draft circulars in progress: two on reporting obligations to the Banco de España; one on conduct requirements; and one on the calculation of contributions to the Deposit Guarantee Fund.
Other new regulatory developments	• In the EU, the following are worthy of note: i) the regulation on crypto-assets (MiCA); ii) the amendment to the regulation and the directive on prudential requirements and supervision (CRR and CRD); iii) the digital finance package presented by the European Commission, which includes a review of the European rules on payment services and a legislative proposal for open finance (FIDA); and (iv) the directive on credit agreements for consumers. • Noteworthy at the national level is the approval of Law 6/2023 on Securities Markets and Investment Services, which entrusts the Banco de España with the supervisory, inspection and sanctioning tasks arising from the MiCA regulation.

1

SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

MICROPRUDENTIAL SUPERVISION

Ensure the solvency, liquidity and smooth functioning of credit institutions and other institutions in the financial system, as well as compliance with prudential regulations. This also contributes to the stability of the financial system

MACROPRUDENTIAL POLICY

Safeguard financial stability, through the use of macroprudential instruments, to prevent and mitigate systemic risks and vulnerabilities

SUPERVISION OF CONDUCT, TRANSPARENCY AND CUSTOMER CARE

In addition to verifying effective compliance with the rules, further banks' cultural transformation towards a responsible banking model, to ensure an appropriate financial relationship with their customers

SUPERVISION OF THE PROVISION OF PAYMENT SERVICES

Safeguard security in the provision of payment services with the aim of promoting an integrated, secure and efficient payments market

OVERSIGHT OF MARKET INFRASTRUCTURES

Promote the smooth operation of payment systems and instruments and ensure that the functioning of securities clearing, settlement and registration systems preserves the stability of the financial system as a whole

OTHER SUPERVISORY FUNCTIONS

Ensure compliance with regulations on covered bonds and simple, transparent and standardised securitisation. Collaboration on AML/CFT supervision with CPMLMO and SEPBLAC and other supervisors

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1.1 Supervisory and oversight functions of the Banco de España

The Banco de España has supervisory powers over credit institutions and over other financial institutions or undertakings related to the financial system operating in Spain. These supervisory and oversight functions are summarised in Figure 1.1.

Microprudential supervision aims to ensure the solvency and liquidity of credit institutions, as well as compliance with prudential regulations. Within the framework of the Single Supervisory Mechanism (SSM), the microprudential supervision of the banking sector is exercised jointly by the European Central Bank (ECB) and the national competent authorities of each country —including the Banco de España— to ensure consistent and standardised supervision among the participating countries. The SSM's objectives, governance, participants and supervisory model can be found at this link.

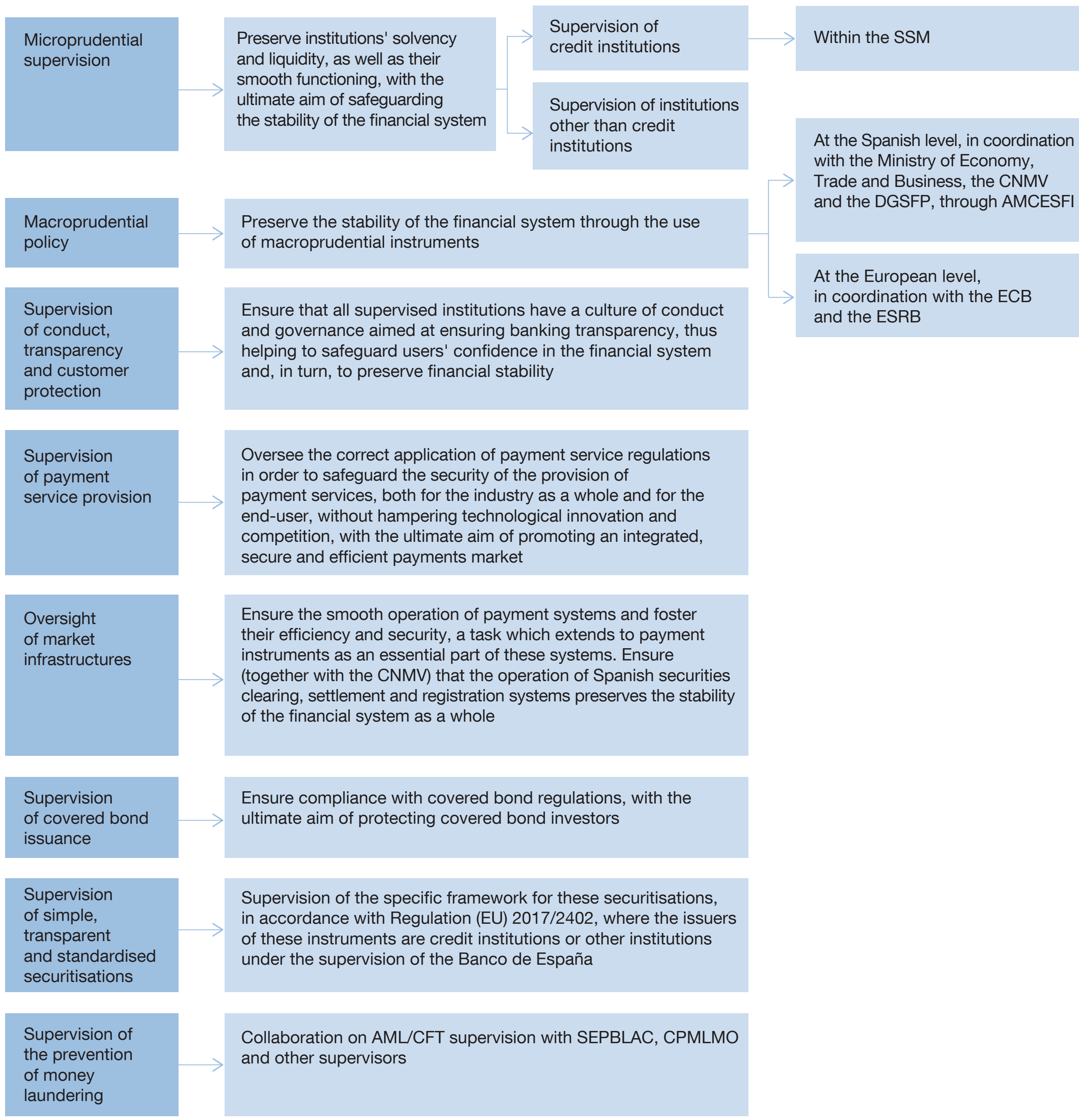
Outside the scope of the SSM, the Banco de España is the supervisory authority of institutions other than credit institutions (see link) that provide services or perform activities related to the financial system.

Macroprudential policy aims to safeguard financial stability through the prevention and mitigation of systemic risks and vulnerabilities (see link). In the exercise of these functions, the Banco de España has macroprudential tools to prevent the accumulation and materialisation of systemic risks in the banking sector and to reduce the effects of their potential materialisation.

The Banco de España participates, together with the Ministry of Economy, Trade and Business, the National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds (DGSFP), in the Spanish Macroprudential Authority Financial Stability Council (AMCESFI), which aims to identify, prevent and mitigate the development of systemic risk factors and contribute to preserving the stability of the Spanish financial system as a whole.

The Banco de España is also responsible for the supervision of institutions' conduct, transparency of information and proper treatment of customers. From a preventive supervision approach, and beyond the verification of effective compliance with the rules, the objective is to further strengthen institutions' culture towards a responsible banking model, as a way of guaranteeing an appropriate financial relationship between institutions and their customers. The functions in the area of conduct can be seen here.

Figure 1.1
SUPERVISORY AND OVERSIGHT FUNCTIONS OF THE BANCO DE ESPAÑA



SOURCE: Banco de España.

The Banco de España is responsible for overseeing payment systems and instruments, and shares with the CNMV the oversight of financial market infrastructures. More information on the oversight of payment systems can be found at this link.

In relation to the supervision of the provision of payment services, there is a specific regulatory framework, the Second Payment Services Directive (PSD2). This framework regulates payment services and payment service providers, placing special emphasis on operational and security risk requirements.

Moreover, as a result of the entry into force of Royal Decree-Law 24/2021,[1] **the Banco de España is responsible for the supervision of covered bonds.** This new regulation enhances investor protection and strengthens the supervisory regime for these instruments. In addition, the Banco de España must authorise covered bond programmes issued under it.

Also, in 2023 the Banco de España assumed the supervision of the specific framework for simple, transparent and standardised securitisations, provided for in Regulation (EU) 2017/2402, when the issuers of these instruments are credit institutions or other institutions under the supervision of the Banco de España, in accordance with Law 5/2015 of 27 April 2015 on the promotion of business financing, as amended by Law 6/2023 of 17 March 2023 on Securities Markets and Investment Services.

Lastly, the Banco de España collaborates closely with the Commission for the Prevention of Money Laundering and Monetary Offences (CPMLMO) and its Executive Service (SEPBLAC) in the supervision and inspection of compliance with the anti-money laundering and countering the financing of terrorism (AML/CFT) obligations of the institutions supervised by the Banco de España, as established by Spanish legislation and the cooperation and coordination agreement entered into with the CPMLMO.

1.2 Organisation of banking supervision and oversight at the Banco de España

The supervisory function is performed by the Banco de España's different directorates general and departments, as detailed in Figure 1.2.

1 Royal Decree-Law 24/2021 of 2 November 2021 on the transposition of European Union directives on covered bonds, cross-border distribution of collective investment undertakings, open data and re-use of public sector information, exercise of copyright and related rights applicable to certain online transmissions and retransmissions of radio and television programmes, temporary exemptions for certain imports and supplies, for consumers and for the promotion of clean and energy-efficient road transport vehicles.

Figure 1.2
ORGANISATION OF BANKING SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

DIRECTORATE GENERAL BANKING SUPERVISION	Significant Institutions Department I	— Ongoing off-site supervision of the three largest Spanish SIs and of the branches and subsidiaries in Spain of European SIs, through the JSTs — Participation in the granting of credit institution start-up licences and in other administrative procedures relating to supervised institutions — Approval of management protocols and financial plans of banking foundations
	Significant Institutions Department II	— Ongoing off-site supervision of the seven other Spanish SIs through the JSTs — Participation in the granting of credit institution start-up licences and in other administrative procedures relating to supervised institutions — Approval of management protocols and financial plans of banking foundations
	Department of LSIs and other Institutions outside the SSM	— Supervisory action planning for LSIs and the other institutions under its supervision — Ongoing off-site supervision and on-site inspections of: • Spanish LSIs • Other institutions outside the scope of the SSM: ICO, SLIs, PIs, account information service providers, ELMIs, MGSs, reguarantee companies, currency-exchange bureaux, appraisal companies and Sareb — Participation in the granting of institution start-up licences and in other administrative procedures relating to supervised institutions
	Department of Inspections, Internal Models and AML	— On-site inspections and internal model investigations of SIs within the SSM — Internal model investigations of LSIs — Preparation of technical studies and reports for departments of the Banco de España — Planning, implementation and monitoring of AML/CFT supervisory actions
	Horizontal Functions Department	— Horizontal analysis of risks (such as credit risk, business risk, operational risk, liquidity risk, etc.) — Establishment of supervisory policy and development of supervisory methodology — Definition of bank accounting regulations and handling of related queries — Supervision of covered bond issues and of simple, transparent and standardised securitisations — Coordination of DG.SUP participation in the stress tests of Spanish institutions — Market risk and structural liquidity and interest rate risk inspections — Preparation of technical studies and reports for Banco de España services and external agents — Development of supervisory support tools to exploit the information available at the Banco de España
	SSM Coordination and Supervisory Strategy Department	— Preparation and monitoring of annual supervision planning — Definition of SSM supervisory strategic planning and second line of defence — Coordination, support and advice for the Banco de España's participation in Supervisory Board meetings and other SSM events — On-site IT risk inspections of SSM SIs and of LSIs — Assessment of Spanish regulatory sandbox projects and enhancement of the sector's cyber resilience — Promotion of technological innovation in the DG.SUP
	Organisation and Quality Division (Corporate Functions)	— Quality control in the supervisory process — Training of DG.SUP staff — Coordination of DG.SUP corporate functions and IT security
DIRECTORATE GENERAL FINANCIAL STABILITY, REGULATION AND RESOLUTION	Financial Stability and Macroprudential Policy Department	— Analysis of financial system risks and vulnerabilities — Formulation of macroprudential policy proposals — Coordination with AMCESFI, the ESRB and the ECB's macroprudential function — Stress tests (FLESB)
	Financial Reporting and CCR Department	— Receipt, quality control and forwarding of supervisory information that credit institutions and other supervised institutions are required to submit to the ECB and to the Banco de España — Management of the Central Credit Register and of Anacredit — Calculation and validation of compliance with the minimum reserve ratio — Preparation of financial statistics and draft regulations on regular reporting by institutions
	Regulation Department	— Analysis, definition and monitoring of regulatory policies applicable to supervised institutions — Coordination with the EBA, FSB, BCBS and other international fora — Development and interpretation of prudential regulations
GENERAL SECRETARIAT	Deputy General Secretariat	— Participation in the assessment of compliance with suitability requirements for SI senior officers — Maintenance of the Senior Officer Register — Participation in the granting and withdrawal of institutions' authorisation — Maintenance of the Register of Institutions and of Agents in Spain and issuance of certifications on the information contained therein — Management of the single European passport — Supervision of vetted access to activity and name reservation — Availability to the public of registers published on the Banco de España and EBA websites
	Legal Department	— Handling of sanctioning proceedings — Advice to the Banco de España's governing bodies and departments on matters relating to its powers, including its functions as central bank and member of the ESCB and as supervisor and member of the SSM and the SRB
DIRECTORATE GENERAL FINANCIAL CONDUCT AND BANKNOTES	Institutions' Conduct Department	— Supervision of market conduct and compliance with information transparency and customer protection regulations of supervised institutions through onsite inspections and ongoing monitoring — Preparation of regulations and circulars on conduct, transparency and customer protection — Participation in international committees on regulation and supervision

SOURCE: Banco de España.

Figure 1.2
ORGANISATION OF BANKING SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA (cont'd)

DIRECTORATE GENERAL OPERATIONS, MARKETS AND PAYMENT SYSTEMS	Payment Systems Department	— Ongoing supervision of compliance with regulations on payment services at credit institutions, PIs, ELMIs and account information service providers — Definition of supervisory policy regarding the provision of payment services — Participation in the granting of authorisations and registration of payment service providers other than credit institutions — Supervision of Iberpay as the management company of the National Electronic Clearing System — Support for and oversight of financial market infrastructures and payment instruments
	Financial Innovation and Market Infrastructures Department	— Coordination of the Banco de España's participation in the controlled testing space known as regulatory sandbox

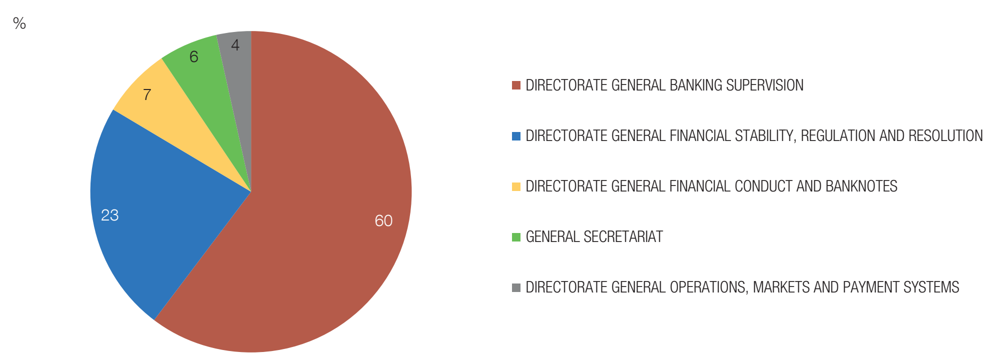
SOURCE: Banco de España.

1.3 Supervisory and oversight staff

At 31 December 2023, the Banco de España had 894 employees performing supervisory and oversight functions, distributed by directorate general as shown in Chart 1.1.

Chart 1.2 shows the distribution, by professional group and gender, of Banco de España employees who carry out supervisory functions. Of these, 47.9% are men and 52.1% are women, although the distribution varies by professional group.

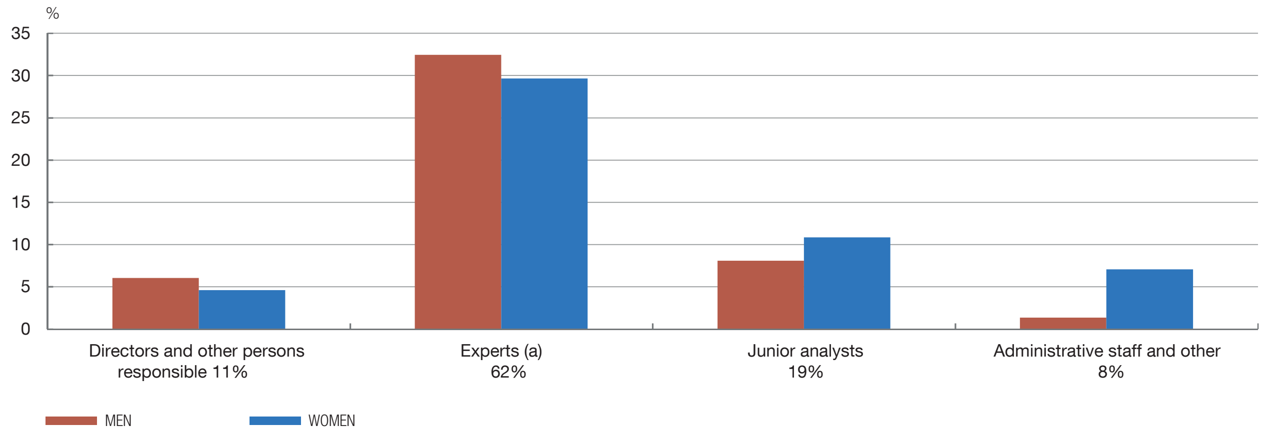
Chart 1.1
SUPERVISORY AND OVERSIGHT STAFF, BY DIRECTORATE GENERAL
At 31 December 2023



SOURCE: Banco de España.

Chart 1.2
SUPERVISORY AND OVERSIGHT STAFF, BY GENDER AND PROFESSIONAL GROUP
At 31 December 2023

The proportion of men and women is almost equal in three professional groups, notably including “Directors and other persons responsible” due to its significance. However, there are major disparities in “Administrative staff and other”.



SOURCE: Banco de España.

a Also includes inspectors, economists, lawyers, inspection auditors and IT auditors.

2

MICROPRUDENTIAL SUPERVISION

SUPERVISION OF CREDIT INSTITUTIONS

Exercised within the SSM: (i) 10 Spanish SI groups supervised by the ECB, with key participation of the Banco de España; and (ii) 56 Spanish LSI groups supervised directly by the Banco de España, with indirect supervision by the ECB

2023 FOCAL POINTS

i) Strengthening resilience to macro-financial and geopolitical shocks; ii) addressing structural vulnerabilities: digitalisation and technology risks, governance, and iii) incorporating climate risks into risk strategy and management

2024 SUPERVISORY PRIORITIES

i) Increasing resilience to macro-financial and geopolitical shocks; ii) improving governance and climate risk management; and iii) making progress in digital transformation and operational resilience

MEANS OF SUPERVISION

Two means of supervision: (i) ongoing off-site, which keeps the institutions' risk profile up-to-date, with the SREP being the core element ; and (ii) on-site, which encompass inspections and model investigations

STRESS TESTS ON CREDIT INSTITUTIONS

They assess credit institutions' strength in the face of financial and economic shocks

ANTI-MONEY LAUNDERING

The Banco de España supervises certain AML/CFT obligations (due diligence, internal control and reporting) and cooperates closely with the CPMLMO

2.1 The Spanish banking sector

At 30 September 2023, the consolidated assets of the Spanish banking sector institutions totalled €4,161 billion, of which 90.4% corresponds to Spanish significant institutions (SIs), 5.2% to Spanish less significant institutions (LSIs) and the Official Credit Institute (ICO), and the remaining 4.4% to subsidiaries and branches in Spain of foreign credit institutions.

In 2023 (Chart 2.1), there was a reduction in the total consolidated credit balance of Spanish institutions. This was due to: i) the decline since the peak in 2022 in cash balances at central banks and demand deposits at other credit institutions, and ii) the significant contraction in lending in Spain across all segments. In the latter case, there was a decrease in loan origination due to the fall in demand for credit, and a tightening of the conditions applied to new loans, accompanied by a significant volume of early repayments. The decline in Spain was only partially offset by activity abroad.

For now, there is no significant deterioration in credit quality indicators, despite the uncertain economic environment. The NPL ratio remains at the same levels as at the end of 2022 (Chart 2.2). However, slight upturns in NPLs were observed in the consumer and mortgage segments, mainly in the latter part of the year.

As for liquidity, after the decline observed in 2022 in the short-term ratios (LCRs), in 2023 the ratios have remained stable at comfortable levels. This positive performance was due mainly to an improvement in the commercial margin, helped by lower demand for credit, and occurred despite both early and ordinary TLTRO III (Targeted Longer-Term Refinancing Operations III) repayments (Chart 2.3).

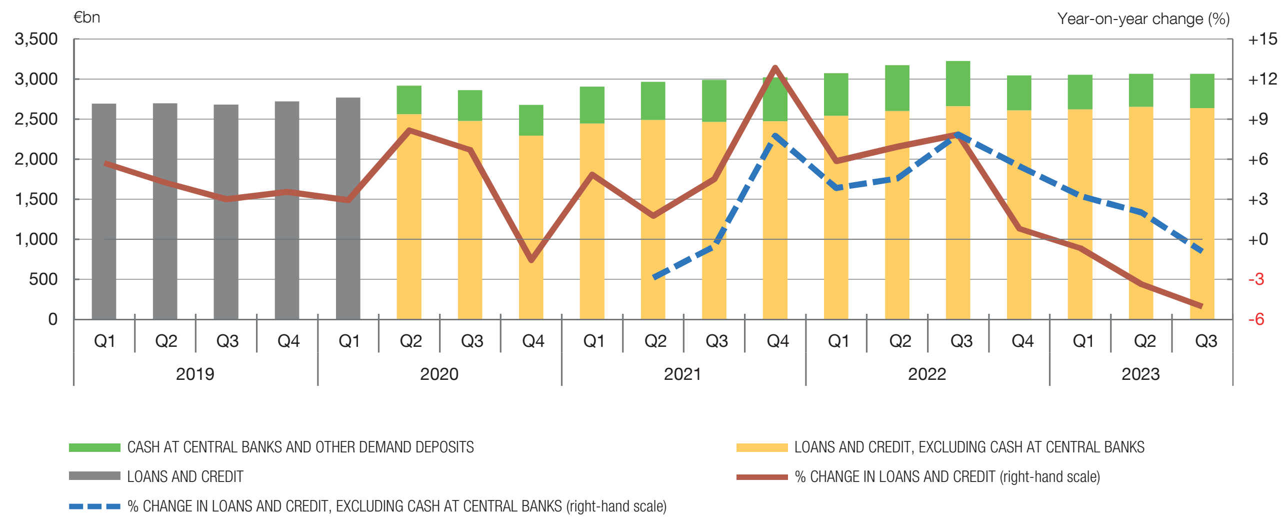
In 2022 TLTRO III was repaid for an amount representing 55% of the total requested. In 2023 repayments continued, mainly in the first half of the year, up to an additional 34%. This was achieved by reducing balances deposited in the ECB deposit facility, by increasing debt issuance and liabilities vis-à-vis the financial system, and by mobilising the debt portfolio through repos. The outstanding balance of TLTRO III in the third quarter of 2023 was 11% of the initially requested amount, and the bulk of the remaining repayment will occur in March 2024.

Moreover, Spanish institutions maintain growing levels of profitability (12.3% ROE at September 2023), above pre-pandemic levels for the third consecutive year (Chart 2.4), despite the temporary bank levy, which in 2023 amounted to €1,236 million. Profit from ordinary business increased in 2023, due to the greater contribution of net interest income.

Chart 2.1

LOANS AND CREDIT. DEVELOPMENTS IN CONSOLIDATED BALANCES (a)

Credit stagnation. In 2023, the credit balance in households and companies in Spain contracted. There was a decline in demand in a context of investor uncertainty, a tightening of the financial conditions applied to new transactions (basically interest rates) and the use of borrowers' non-interest bearing deposits to make early repayments.



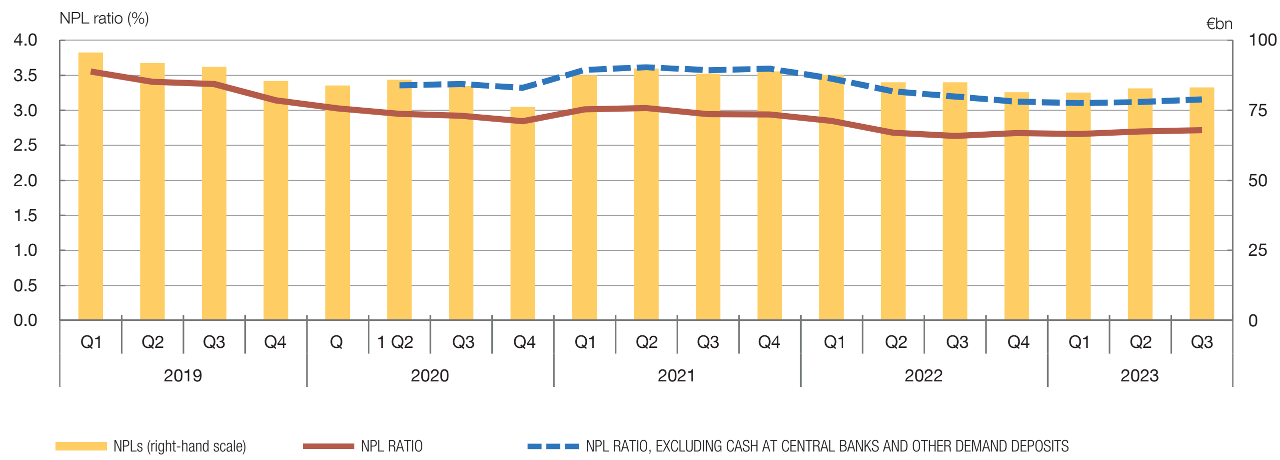
SOURCE: Banco de España (supervisory statistics on credit institutions).

a Loans and credit include cash balances at central banks and other demand deposits, broken down since Q2 2020.

Chart 2.2

NPLs AND NPL RATIO (a)

Stability in NPL balances and ratios. Throughout 2022 there was a slight contraction, accentuated by the sale of damaged portfolios and an effort to write down impaired portfolios. In the last months of 2023, on the other hand, minor deteriorations can be discerned in certain segments (consumer and mortgages).



SOURCE: Banco de España (supervisory statistics on credit institutions).

a NPL ratio calculated including cash balances at central banks and other demand deposits and, since Q2 2020, also excluding these balances.

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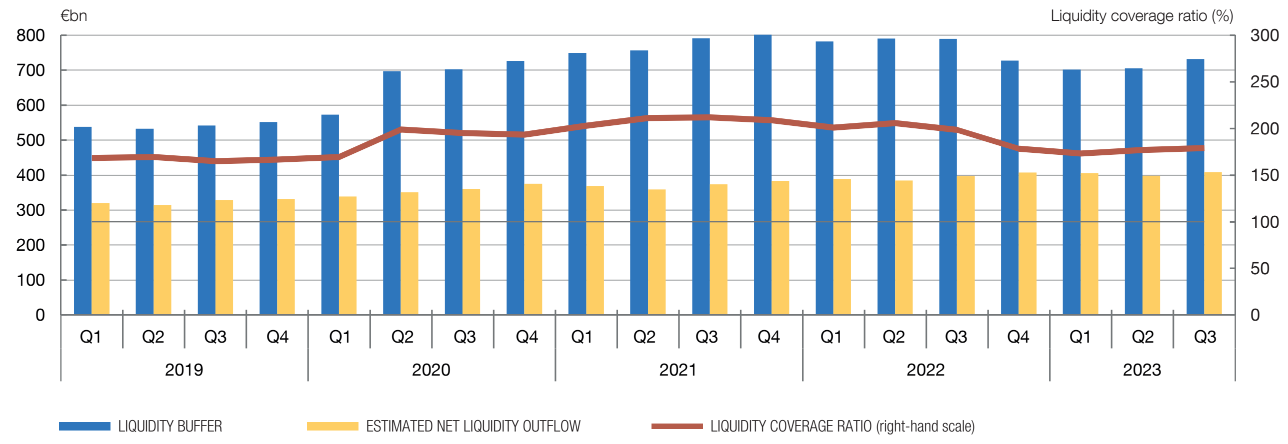
Chart 2.3
LIQUIDITY COVERAGE RATIO

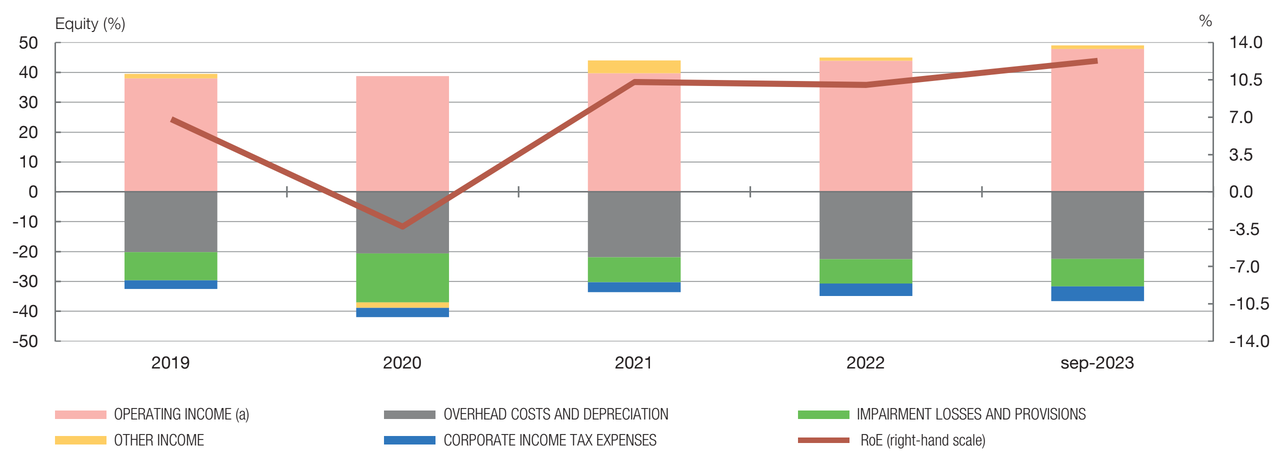
The liquidity coverage ratio exceeded pre-pandemic levels in 2023, with a slight upward trend, albeit lower than the ratios observed in 2020 and 2021.



SOURCE: Banco de España (supervisory statistics on credit institutions).

Chart 2.4
RoE BY COMPONENTS. ANNUAL CHANGE

Following the consolidation of the recovery in return on equity (RoE) to the levels prior to the pandemic in 2021-2022, the continued interest rate rises since mid-2022 have greatly bolstered Spanish institutions' net interest income, significantly increasing their RoE.



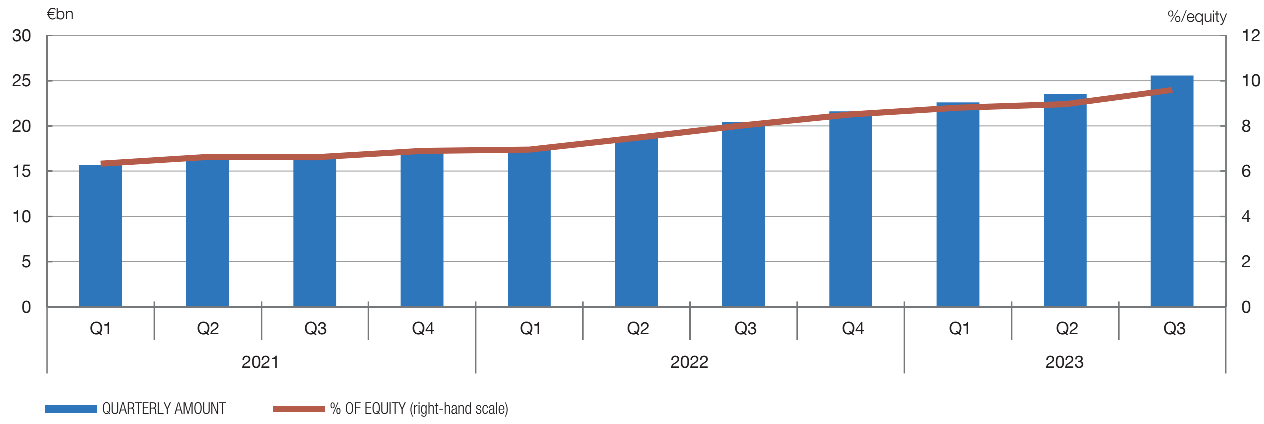
SOURCE: Banco de España (supervisory statistics on credit institutions).

a Operating income is the sum of net interest income, net fee and commission income, net income from financial operations, net foreign exchange differences and other net operating income.

In this respect, recent interest rate developments have led to strong growth in net interest income (Chart 2.5), due to: (i) the combination of the rapid rise in rates with high, albeit declining, volumes of floating-rate lending; and (ii) the slower repricing of deposits, especially from individuals, in a context of high liquidity in the system and lower demand for credit.

Chart 2.5
NET INTEREST INCOME

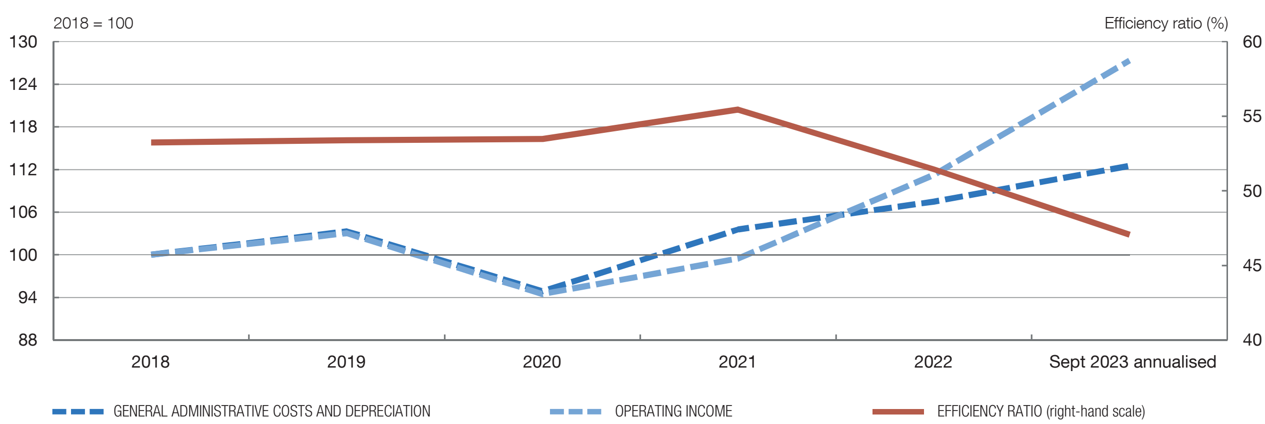
Since the start of the ECB interest rate rise in June 2022, the growth in net interest income has accelerated due to the faster rate of interest rate appreciation of assets than liabilities.



SOURCE: Banco de España (supervisory statistics on credit institutions).

Chart 2.6
EFFICIENCY RATIO

Significant improvement in the efficiency ratio due to the higher increase in operating income relative to overhead costs.



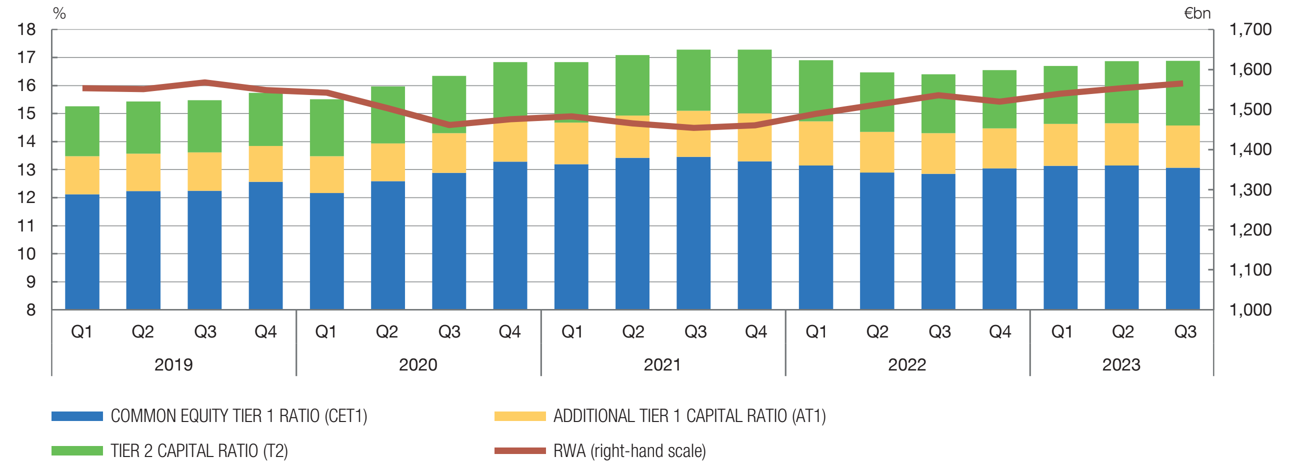
SOURCE: Banco de España (supervisory statistics on credit institutions).

The efficiency ratio, in turn, performed favourably due to the improvement in operating profit that exceeded the increase in overhead costs, which are growing mainly as a result of higher inflation (Chart 2.6). At the same time, loan impairments have remained moderate despite the context of high macroeconomic uncertainty.

As regards solvency, Spanish institutions maintain record high levels (16.9% total capital ratio at September 2023) with a slight improvement in 2023 owing to the contribution of profit and the moderate increase in risk-weighted assets (RWA) (Chart 2.7). This growth in RWA was due to the dynamism of foreign activity, as domestic activity declined.

Chart 2.7
CAPITAL RATIOS (a)

Stability of capital ratios at record high. Slight improvement in 2023 since the generation of retained earnings exceeded the moderate increase in risk-weighted assets.



SOURCE: Banco de España (supervisory statistics on credit institutions).

a The ratios are presented in order from higher to lower quality: CET1, T1 (sum of CET1 + AT1) and total capital (CET1 + AT1 + T2), measured with respect to risk-weighted assets (RWA).

If we distinguish between SIs and LSIs, while SIs had total aggregate capital levels of 16.6% at September 2023 and an optimised inter-tier composition (12.6% CET1, 1.6% AT1 and 2.4% T2), aggregate capital levels at LSIs were much higher (20.4% at September 2023) and consisted almost exclusively of CET1, the highest quality capital.

In relation to operational risk, the number and diversity of events continue to increase, although total losses remain within the levels recorded in recent years. The proliferation of events arose mainly in the conduct and customer, technology and fraud risk categories, in an environment of greater potential risk due to digitalisation and outsourcing processes, remote working and other salient factors, such as the new conduct regulations and rulings.

In short, the impact of the pandemic has been overcome, with higher levels of profitability and solvency, but signs of a slowdown in economic activity are beginning to emerge, calling for caution. Institutions are attaining high profitability levels as a result of: i) the improvement in the net interest income related to a faster transmission of monetary policy to assets than to liabilities; ii) the moderate increase in wage and overhead costs in response to the inflationary process; and, in particular, iii) the continued stable loan impairments.

In view of the situation of macro-financial uncertainty, it would be desirable for institutions to take advantage of this current favourable situation and apply prudent policies in their capital planning and returns and in their credit risk coverage. High growth in net interest income is unlikely to be sustained in the medium term, especially considering the reduction in credit in the domestic market, and there is a possibility of increased impairment of loan portfolios.

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2.2 Restructuring of technology risk supervision

One of the initiatives of the Banco de España's Strategic Plan is to become a benchmark in the supervision of technology risk, an objective that is fully aligned with the growing importance that the supervision of this risk has acquired both for the Single Supervisory Mechanism (SSM), and for the other international regulatory and supervisory bodies, such as the European Banking Authority (EBA), the European Systemic Risk Board (ESRB), the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB), etc.

In the framework of the SSM, technology risk has emerged in recent years as one of the main supervisory priorities. The relevance of this risk has been increased by the institutions' rapid digitisation, more pronounced following the pandemic, and by the rise in cyber incidents, which is especially relevant in the current geopolitical environment. Also, the increasing use of outsourcing of critical technology services to external providers poses an added challenge for supervisors.

In this context, at the European level, the supervisory panorama for technology risk is changing significantly and poses major challenges, including most notably:

— Authorities' difficulties in recruiting and retaining experts capable of supervising institutions' technology risk. The general shortage of expertise in the market is compounded by the difficulty in competing on working conditions with the private sector.

— The new supervisory powers stemming from the EU's digital finance strategy, including the Digital Operational Resilience Act (DORA), the new Directive on Security of Network and Information Systems (NIS2), the Markets in Crypto-Assets Regulation (MiCA) and the Artificial Intelligence Regulation.

To cover the functions derived from this new scenario, which are added to those traditionally carried out by the IT auditors of the Directorate General Banking Supervision (DG.SUP), it is necessary to standardise working procedures to achieve an adequate harmonised level of knowledge of our institutions' technological situation, strengthen our presence in national and international working groups and promote the exchange of knowledge in innovation, new technologies and operational resilience among the entire group of experts.

With these objectives in mind, a new approach to the organisation of IT auditors has been implemented since the end of 2022, the most noteworthy change being the creation of the SSM Coordination and Supervisory Strategy Department, with a sub-directorate whose main objective is to improve the coordination of technology risk supervision. Two technology risk groups report to this sub-directorate: the first group is in charge of on-site inspections for both SIs —within the framework of the SSM— and LSIs; the second is a horizontal group which, among other tasks, deals with the TIBER-ES advanced cybersecurity testing framework, assessing regulatory Sandbox projects, ensuring adequate participation in the main national and international working groups and providing support to the other departments of DG.SUP. The sub-directorate is responsible for ensuring unity of action between the two groups through the application of uniform technical criteria, encouraging the exchange of experience, knowledge and new developments from the fora in which this risk is discussed.

Governance has also been designed (including the creation of several committees or a technology risk coordinator) with the aim of facilitating the exchange of information between this sub-directorate and the IT auditors in the teams responsible for supervising institutions. It should be noted that the presence of at least one IT auditor in each of the Joint Supervisory Teams (JSTs) of Spanish institutions is unique in the SSM.

2.3 Supervisory priorities

The SSM establishes a set of supervisory priorities for SIs with a medium-term horizon of three years, reviewable annually, following a process that revolves around the identification of risk sources and vulnerabilities specific to the banking sector. Thus, risk-based supervision is strengthened and supervisory effectiveness and efficiency are enhanced. The priorities take into account the findings of the Supervisory Review and Evaluation Process (SREP) and progress made on previous years' priorities. This materialises in a multi-year plan of supervisory activities, with specific annual plans.

The Banco de España uses a similar process to set the supervisory priorities for LSIs on an annual basis.

2.3.1 Supervisory priorities in 2024

The supervised institutions have suffered several macro-financial and geopolitical shocks over the last few years and have shown resilience. Nevertheless, the challenges ahead are not minor ones, and include a potential deterioration of credit quality, potential rises in banks' funding costs and increases in the risk premium that could lead to higher market volatility.

On the other hand, pre-existing challenges related to more structural aspects remain relevant, including the development and implementation of digital transformation strategies, mechanisms for tackling technology risk or challenges stemming from climate change.

The new supervisory priorities are a continuation of the priorities set last year, albeit with some adjustments. The SSM priorities for the SIs are set out in Figure 2.1, and more details can be found at this link.

Figure 2.1
SI SUPERVISORY PRIORITIES FOR 2024-2026

	1 MACRO-FINANCIAL AND GEOPOLITICAL SHOCKS	Credit and counterparty risk	Although both companies and households have shown resilience in the current economic environment and NPL ratios are at historically low levels, there are signs that point to a deterioration — Institutions should continue to strengthen credit risk management through the early identification and mitigation of any build-up of risks, with a particular focus on sectors that may be most adversely affected in the current economic environment
		Funding and interest rate risk	The interest rate environment has changed significantly over the past two years. Rising interest rates may lead to higher funding costs, impacting asset and liability management and liquidity — Banks should develop credible funding plans, diversifying their funding structures, and have effective contingency plans to withstand short-term liquidity shocks — Banks should ensure the management of their interest rate risk positions reflects prudent assumptions about customers' behaviour and develop mitigation strategies adapted to their risk profile
	2 GOVERNANCE AND CLIMATE RISK	Governance	The crisis in some banks in the US and Switzerland has highlighted the importance of governance and risk control and of effective supervision — Institutions should continue to make progress in improving the functioning and capabilities of governing bodies, in view of the need to boost the development of areas such as the composition of boards (e.g. ensuring a sufficient number of independent directors and knowledge in areas such as technology), their functioning (e.g. increasing time allocated to discussions or improving nomination processes), collective suitability and their supervisory capacity — Banks should have appropriate risk data aggregation and risk reporting frameworks
		Climate and environmental risk management	In a context of rising global greenhouse gas emissions, the delay in the implementation of measures to protect the climate is expected to further increase physical and transition risks and, possibly, losses for institutions — Banks should incorporate climate and environmental risks into their business strategy and their governance and risk management framework, in order to mitigate them and inform the public, aligning their practices with regulatory requirements and supervisory expectations
	3 DIGITAL TRANSITION AND TECHNOLOGY RISK	Digital transition	While cost containment may be a challenge in the current inflationary environment, institutions should manage this situation without undermining investments in digital transformation, which are expected to strengthen institutions' competitive position — Banks should develop and execute sound digital transformation plans to strengthen the sustainability of their business model and mitigate the risks of using innovative technologies
		Technology risk	Cyber risk and data security are still the main operational risk factors for credit institutions. There was an increase in the number of cyber incidents reported to the ECB by SSM institutions in the first half of 2023. Also, the increased complexity of value chains forces institutions to improve their understanding and control of their third-party relationships. The ECB has established an outsourcing register that has identified vulnerabilities, including a high dependence on certain non-European suppliers — Banks should have robust mechanisms in place to address outsourcing risk and make further progress in building robust operational resilience frameworks

SOURCE: Banco de España.

Certain specific tasks that will be carried out to meet the objectives set out in the action priorities established by the SSM for the SIs are described below:

1 **Increase resilience to macro-financial and geopolitical shocks**

In order to strengthen credit and counterparty risk management, supervisory activity will maintain the status quo and will continue to monitor the persistent shortcomings among those identified in 2020 as part of the supervisory response to the pandemic situation, i.e. shortcomings relating to restructured transactions, subjective NPLs and provisioning policies. Also, reviews will be performed on International Financial Reporting Standard 9 (IFRS 9) and on internal models of the most sensitive portfolios at the current time. As for counterparty risk, the JSTs will monitor exposures and risk management in order to assess progress on the shortcomings identified in 2022.

Secondly, in relation to funding and interest rate risk, specific asset and liability management reviews will be performed, and the short-term resilience to liquidity shocks, the credibility and strength of liquidity contingency plans and funding plans will be assessed.

2 **Accelerate the effective remediation of shortcomings in governance and climate and environmental risk management**

In relation to improving the functioning of management bodies, shortcomings will continue to be addressed through specific reviews and on-site inspections, and supervisory expectations on governance and risk management will be updated. Moreover, with regard to risk data aggregation and reporting, guidance on this matter is expected to be published in 2024 and specific reviews and on-site inspections will be carried out.

In relation to climate and environmental risk, reviews will continue to be performed of compliance with supervisory expectations, the publication of information and the reputational and litigation risks stemming from disclosure of transition targets and/or net-zero commitments. Also, progress will be made on preparatory work for the development of a framework for the review of banks' transition plans and their ability to deliver on the environmental, social and governance mandates of the Capital Requirements Directive (CRD-VI), and certain on-site inspections will be carried out. In the longer term, available tools will continue to be used to ensure that institutions meet supervisory expectations, including, if necessary, periodic coercive payments or additional capital requirements.

3 **Further progress with digital transformation and building robust operational resilience frameworks**

The ECB will publish its supervisory expectations on digital transformation, with a focus on strengthening the assessment methodology. Also, in order to further progress with digital transformation, specific reviews will be combined with on-site inspections.

As regards technology risk, in order to progress towards building robust operational resilience frameworks, the ECB will continue to perform outsourcing reviews and assess cyber resilience. Similarly, a cyber resilience stress test will be conducted in 2024 in the system as a whole.

Bearing in mind the SSM risks and priorities, the Banco de España also identified the risks particularly affecting Spanish LSIs. On this basis, the following priorities were established:

- **Credit risk.** Attention will be paid to the identification of shortcomings in granting, monitoring, accounting classification and loan-loss provisioning policy, to possible concentration of risk in vulnerable sectors and to possible increases in NPLs due to the rise in interest rates.

- **Liquidity risk management policies and procedures.** Although Spanish LSIs have high liquidity levels, as a result of events in 2023 in some US banks, the SSM has included liquidity among its priorities for 2024 and has planned activities for all national competent authorities (NCAs), and, therefore, liquidity management procedures and tools will be reviewed.

- **Interest rate risk in the banking book (IRRBB) management policies and procedures.** Attention will be paid to the impact on medium-term profitability in institutions with large held-to-maturity investment portfolios.

- **Internal governance.** Monitoring will continue on the remediation of the shortcomings identified in the horizontal action carried out in 2021 and the shortcomings related to the functioning of the three lines of defence.

- **Climate risk identification, measurement and management.** Assessments will be performed of the following: i) the ability to mitigate climate risks; ii) the information available on climate risks; iii) compliance with regulatory requirements; and iv) plans for transition to a sustainable economy.

- **Business model and sustainability.** The analysis will be focused on: i) medium-term sustainability in a context of lower business generation; ii) the institution's preparedness to adapt to technological change (digitalisation of business); and iii) the recommendations and requirements made under the framework of the 2022 horizontal review.

- **Operational risk and, in particular, technology risk.** The analysis will be focused on: i) the assessment of operational resilience frameworks; ii) the monitoring of the

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recommendations and requirements made in the 2023 horizontal review on technology risk and its control framework; and iii) the monitoring of the recommendations and requirements stemming from the horizontal review of the management of the outsourcing of critical functions.

The various supervisory tools are used to implement the supervision plan: the SREP; in-depth reviews, such as specific in-depth or horizontal reviews, as well as on-site inspections. Also, the tools linked to compliance with requirements are gradually improving; these tools include the use of ever more intrusive measures, which will be particularly significant in ensuring institutions' remediation of the shortcomings identified.

2.3.2 Supervisory focal points in 2023

The SSM's identification of risks in relation to significant institutions for 2023 was based on an economic environment in which the pandemic crisis had given way to a framework characterised by geopolitical tensions, high levels of inflation and the rise in interest rates, together with increasing public indebtedness, highly volatile asset valuations and a potential deterioration in credit quality in the face of the withdrawal of institutional support measures. In this context, there was some concern about the possible deterioration of asset quality and/or an increase in the cost of bank funding. Also, a number of structural challenges continued to be identified, including digital transformation and the risks stemming from climate change.

Against this backdrop, three major objectives were set: increase resilience to macro-financial and geopolitical shocks; continue to address institutions' structural vulnerabilities —regarding governance, technology risk and digital transformation—; and continue to adapt the business strategy and risk management framework to climate risk. These objectives were broken down into 6 supervisory focus areas and guided activity for the SSM as a whole in 2023, with logical adaptations in view of the evolving environment, including the crisis of certain banks in the United States and Switzerland in early 2023 and geopolitical risks.

As for credit risk, the SSM was focused on addressing shortcomings in credit risk management frameworks, and it concluded that banks have made progress, but that more work needs to be done in areas such as the anticipation of emerging risks (including climate risk), the adequacy of recognised provisions and the management of debtors facing difficulties.

With regard to funding risk, which was incorporated as a supervisory priority last year, institutions have shown strong resilience in a context of restrictive monetary policy, although liquidity buffers have been reduced. A review of TLTRO III exit strategies was conducted over the course of 2023 and, as a result, some SSM banks were required to further increase the diversity of their funding sources. However, the degree of concentration of European SIs' funding sources was not comparable to that of the US banks that went into crisis at the beginning of 2023, thanks to the greater weight of retail deposits covered by guarantee funds.

Supervisory activity on governance was focused on monitoring the shortcomings identified. Improvements were seen in diversity policies, which now include education, experience, geographical origin and age criteria, as well as gender. However, following the specific review of institutions' governing bodies carried out in 2023, shortcomings were identified in the composition of boards, in their functioning and in their supervisory capacity. As regards risk data aggregation and risk reporting, a questionnaire was submitted to institutions on data governance and data quality, and the planned supervisory activities continued.

In 2022-2023 the SSM conducted a horizontal assessment and a benchmarking analysis of digital transformation and the use of FinTech. The outcome of this analysis was shared in early 2023 and helped classify risks in the categories of strategic and execution risks, cyber risk, outsourcing risk, and money laundering and fraud risks. Subsequently, a targeted review was launched on these issues to assess the institutions' digitisation strategies.

Supervision of technology risk consisted of horizontal reviews and on-site inspections throughout the year, with the aim of strengthening the cyber risk and IT security frameworks and outsourcing arrangements. In addition, data from outsourcing arrangements were collected to identify connections between significant institutions and technology service providers, and the potential concentration of certain technology service providers.

Lastly, with regard to climate risk, specific requirements were established for banks to align their practices with supervisory expectations based on the shortcomings identified in the stress tests and horizontal review conducted by the ECB in 2022. Specifically, as early as March 2023, institutions were required to adequately categorise climate and environmental risks and conduct a full assessment of the impact they could have on their activities. Certain institutions showed severe weaknesses that will be subject to supervisory monitoring.

Following a similar process, the Banco de España identified the key risks affecting Spanish LSIs and focused its work in 2023 on the following elements:

i) **Credit risk management,** paying particular attention to: i) the identification of shortcomings in granting, monitoring, accounting classification and loan-loss provisioning policy, and ii) the possible concentration of risk in vulnerable sectors. The conclusion is that there is room for improvement in the monitoring of risks and in the classification and sufficiency of loan-loss provisions recorded for troubled assets.

ii) **The business model and medium-term sustainability.** An analysis was made of institutions' preparedness to adapt to technological change (digitisation of the business) and institutions' response to the recommendations and requirements made in 2022 as a result of the cross-institutional business model review. In general, although progress has been made, there are still areas where more work needs to be done.

iii) **Operational risk and, in particular, technology risk.** All LSIs were reviewed; institutions' responses to the questionnaire sent in 2022 were assessed; and it was concluded that there is room for improvement in technology risk management. In addition, in relation to the outsourcing of critical functions and in order to close the horizontal action commenced in 2022, compliance with the provisions of Circular 2/2016 and the Guidelines on outsourcing arrangements EBA/GL/2019/02 was reviewed, and the adaptation of outsourcing agreements was found to be largely completed.

iv) **Governance.** Monitoring was performed as to the remediation of the shortcomings identified in previous horizontal actions and compliance with EBA guidelines on internal governance and remuneration policies. It was concluded that the functioning and composition of the management body and the independence and allocation of resources of the second and third lines of defence still have scope for improvement.

v) **Capital planning.** Reviews were performed of compliance with capital projections and assumptions and the frequency with which they are updated, and progress on the stress tests that institutions include in their capital adequacy assessment reports, mainly at institutions with a business model other than retail banking, following on from the recommendations for improvement made in 2022.

vi) **Risks linked to climate change.** Through a questionnaire received in early 2023, assessments were performed of the progress of institutions on incorporating these risks into their business strategy, governance and risk management frameworks, and their capacity to mitigate and report them, comply with regulatory requirements and evolve towards the transition of the economy. Consequently, recommendations in this respect were included in the 2023 capital decision letters.

Section 2.4 contains more detailed information on the supervisory activity carried out in 2023 and on the conclusions drawn.

2.4 Supervision of credit institutions

In the framework of the SSM, institutions are classified as either SIs or LSIs depending on their size or relative importance within each country. The ECB is directly responsible for the supervision of SIs and exercises indirect supervision over LSIs, which in the case of Spanish LSIs are supervised directly by the Banco de España (see Figure 2.2).

Table 2.1 shows the breakdown by category of the institutions operating in Spain. At the end of September 2023 there were 10 Spanish groups of SIs (out of a total of 109 groups in the

Figure 2.2
DISTRIBUTION OF SUPERVISORY POWERS ON CREDIT INSTITUTIONS

	Tasks assigned to the ECB within the SSM	Tasks assigned to the NACs within the SSM
Supervision of SIs	Direct supervision of SIs	Support to the ECB for supervision of SIs: participation in JSTs and in on-site missions
Supervision of LSIs	Indirect supervision of LSIs	Direct supervision of LSIs
Common procedures	Common procedures are the responsibility of the ECB, with proposals from the NACs: the granting and withdrawal of authorisation for credit institutions, and authorisations for the acquisition/sale of qualifying holdings in a credit institution	Preparation of the proposal for SIs and LSIs
Penalties	SIs: sanctioning powers in the event of non-compliance with directly applicable EU law, except for non-financial penalties and penalties for natural persons LSIs: sanctioning powers in the event of non-compliance with an ECB decision or regulation	SIs: sanctioning powers, after instruction from the ECB, for non-compliance with national legislation transposing EU directives; for infringements attributable to its directors and executives; and for the purpose of imposing non-financial penalties LSIs: sanctioning powers for other cases of non-compliance, in some cases after ECB's instruction

SOURCE: Banco de España.

Table 2.1
BANKS OPERATING IN SPAIN
Data at 30 September

	2022			2023		
	Number of groups	No. of banks in these groups	Market share in terms of assets (%)	Number of groups	No. of banks in these groups	Market share in terms of assets (%)
Spanish SIs	10	39	90.5	10	39	90.4
Other SSM SIs in Spain via subsidiary/branch	29	43	3.6	34	46	3.9
Spanish LSIs	56	68	5.5	56	67 (a)	5.2
Branches of other SSM LSIs	38	38	0.3	34	33	0.4
Branches of non-EU banking groups	4	4	0.2	4	4	0.1
TOTAL	**137**	**192**	**100.0**	**138**	**189**	**100.0**

SOURCE: Banco de España.

a 23 banks, 42 cooperatives and 2 savings banks.

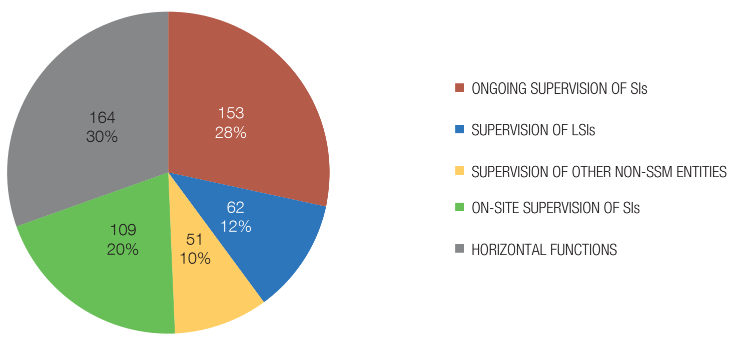
Table 2.2
REGISTER OF CREDIT INSTITUTIONS

Data at 31 December

	2022	2023
Credit institutions	194	189
Banks	48	47
Savings banks	2	2
Credit cooperatives	61	61
ICO	1	1
Branches of EU credit institutions	78	74
Branches of non-EU credit institutions	4	4
Financial holding companies	3	7
Mixed financial holding companies	1	1
TOTAL	**198**	**197**

SOURCE: Banco de España.

Chart 2.8
MICROPRUDENTIAL SUPERVISION STAFF



SOURCE: Banco de España.

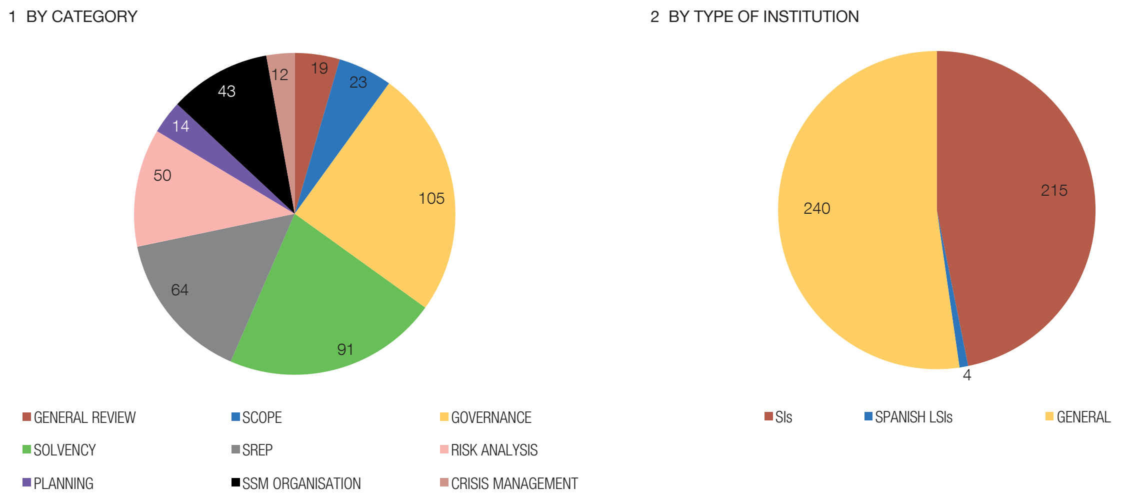
SSM), which accounted for 90.4% of the total assets of the Spanish banking sector. Also, there were 56 groups of Spanish LSIs, which accounted for 5.2% of the total assets of the Spanish banking sector.

Chart 2.8 describes the allocation of staff to the main microprudential supervisory tasks within the Banco de España.

The Banco de España makes an essential contribution to the supervision of Spanish SIs, both through its presence in the JSTs, which are responsible for ongoing off-site supervision, and through its participation in on-site inspections and in model investigations.

Chart 2.9
DISTRIBUTION OF THE ECB DECISIONS AND ACTIONS IN 2023 NOTIFIED TO THE EXECUTIVE COMMISSION

In 2023 there was a significant reduction in the number of decisions as compared to the previous year. However, there was an increase in the number of decisions related to risk analysis and relations with third parties.



SOURCE: Banco de España.

A key element is the SSM working groups and expert networks in which the Banco de España actively participates. These groups analyse and develop technical and supervisory policy proposals with a view to improving the functioning of the SSM.

Also, the Banco de España participates in decision-making regarding all credit institutions under SSM supervision by means of the presence of the Deputy Governor and the Governor on the ECB Supervisory Board and Governing Council, respectively.

In 2023, a total of 2,013 decisions were adopted, of which 459 concerned Spanish institutions, as shown in Chart 2.9.

The supervision of SIs and LSIs is mainly performed through a combination of two complementary channels: i) ongoing off-site supervision, and ii) on-site supervision, for which a range of microprudential tools are available. More information on the supervision model can be found at the following link.

Ongoing off-site supervision aims to keep the risk profile of institutions up to date, and includes a series of periodic and/or ad hoc activities, such as the SREP, in-depth reviews, horizontal reviews, the assessment of compliance with prudential regulations, the suitability assessment of members of management bodies and the acquisition of qualifying holdings.

On-site supervision includes inspections, which can analyse any risk, and internal model investigations for the calculation of capital requirements, which can be for the

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authorisation of a new model or for the review of changes to pre-existing models. These actions involve more thorough reviews of certain aspects, as a complement to ongoing supervision.

In addition, stress tests are also conducted to assess credit institutions' strength in the face of financial and economic shocks. The results of these stress tests are published and allow vulnerabilities to be identified and addressed at an early stage, and they feed the SREP. Accordingly, they may influence Pillar 2 capital requirements (P2R), and the outcome of the adverse scenario serves as the basis for determining Pillar 2 capital guidance (P2G).

2.4.1 Supervision of significant institutions

The JSTs are responsible for the ongoing off-site supervision of SIs. The Banco de España participates in the JSTs of the 10 groups of Spanish credit institutions classified as significant under the SSM criteria. In addition, it also participates in 5 other JSTs (out of a total of 26) which supervise significant banking groups in SSM countries and which have a presence in Spain (through 4 subsidiaries and 41 branches).

Among the recurrent ongoing supervision tasks, a central role is played by those related to the SREP, which is the annual process whereby an institution's risk profile is determined and its capital requirement (P2R and P2G) is assigned.

As a result of the 2023 supervisory exercise, the P2R levels required in 2024 for Spanish SIs have increased by 8 basis points (bps) in aggregate terms, with an increase at four institutions, a decrease at two others and stability at the remaining four.

In turn, the P2G set in that exercise for Spanish SIs has fallen by 14 bps with respect to that of 2022, in aggregate terms. The purpose of this additional buffer is to ensure that banks withstand a stressed period. To this end, a stress test coordinated by the EBA is conducted every two years (see section 2.3.3).

In addition, as a result of the SREP, a letter is sent to the institutions containing (mandatory) requirements and quantitative and qualitative recommendations on matters that should be improved (Chart 2.10).

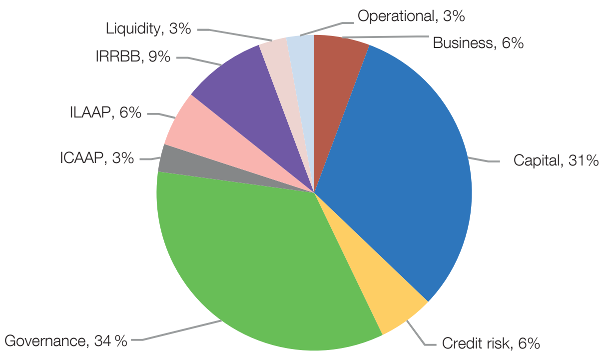
Noteworthy, in 2023 capital requirements and recommendations (P2R and P2G), credit risk and governance have been highlighted. As regards credit risk, the most widespread requirement once again, refers to coverage shortfalls in non-performing exposures, which must be covered by provisions and, failing that, by a capital add-on (CET1). This year, three institutions were required to allocate a specific capital add-on for this reason.

As regards governance, noteworthy are the requirements relating to the need to strengthen the strategic decision-making process; to foster the proper functioning and composition of the Board of Directors and its committees, improving the processes for determining the individual

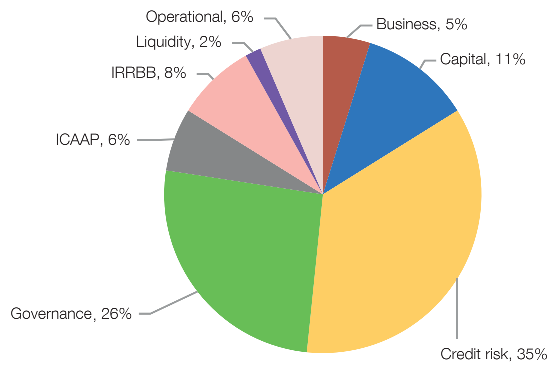
Chart 2.10
2023 SREP REQUIREMENTS AND RECOMMENDATIONS ON SIs

As a result of the SREP, a total of 97 quantitative and qualitative requirements and recommendations were made in 2023, of which 35 (36%) are binding requirements. Noteworthy are the quantitative capital requirements (P2R), as well as the requirements and recommendations on matters regarding governance and credit risk.

1 REQUIREMENTS



2 RECOMMENDATIONS



SOURCE: Banco de España.

and collective suitability of members and the renewal and succession plans for directors; to enhance the documentation submitted to the Board of Directors; and to ensure that the risk management function has an adequate role in the organisation and a degree of independence in line with the level of complexity and with the banking activity carried out by the institutions. Recommendations or requirements were also made in relation to the risk data aggregation and risk reporting capacity, and the effective implementation of the subsidiaries' control systems and the money laundering control model.

In addition to the SREP, the following activities were worthy of note in 2023 in terms of the resources devoted or conclusions reached:

In the area of credit risk, two horizontal reviews were carried out. The first review was to assess risk management practices in residential real estate financing, which concluded that institutions need to make an effort to properly align these risk management practices with EBA guidelines. And the other to analyse and understand how accounting provisioning models capture emerging risks. The general conclusions of the review of the IFRS 9 provisioning models include the following: the need to include emerging risks, such as environmental and geopolitical risks, and to have greater granularity in the quantification of provisions; the preference for the use of in-model adjustments rather than expected loss provisioning; the lack of methodologies for the collective analysis of significant increases in risk; and the desirability of linking such expected loss provisioning to individual risks.

Also, the conclusions of the horizontal review conducted in 2022 on the degree of alignment with the ECB's expectations regarding leveraged finance operations were monitored, which in certain cases gave rise to a letter with recommendations. The main weaknesses relate to the effective implementation of stricter limits on new origination of highly leveraged transactions (as outlined in the ECB guidance), and to improving the management and accounting of syndicated transaction positions.

In-depth reviews of non-performing loans were also performed at six Spanish institutions, highlighting the need, in general, for an improvement in the policies and procedures governing this portfolio.

Lastly, it should be noted that the requirements and the monitoring of the correction of the shortcomings detected in the IRB model review are an important part of the supervisory work carried out by the JSTs.

In relation to business risk, a horizontal analysis was carried out to check institutions' compliance with the new "Implementing Technical Standards reporting and Pillar 3 disclosure" requirements related to climate risk. The conclusion was the need for Spanish institutions to strengthen the climate risk disclosure and reporting framework in order to comply with current regulations.

A targeted review on digitisation was also launched in 2023 and will be completed in 2024, with the aim of identifying credit institutions' digital transformation strategies and use of innovative technologies.

Lastly, in the case of new acquisitions of banks or activities, or the segregation of business, the monitoring of the resulting institution's business model was also a significant focal point in 2023. Thus, analyses were performed of the impact from business acquisitions or spin-offs initiated by Spanish credit institutions on (i) the acquirer's solvency, and (ii) the resulting business model; in addition, the governance and control that the risk management function performs on the financial effects of the operation were also assessed.

In the area of solvency, the JSTs participated actively in the analysis and approval of share buyback programmes by credit institutions, which increasingly use them as part of their ordinary shareholder remuneration policy or as extraordinary remuneration in the event that they consider they need to occasionally distribute excess capital.

In governance, efforts were focused on driving progress in the effectiveness and diversity of management bodies; in particular, identifying potential areas for improvement in the board of directors, the nominations and remuneration committees, and the internal audit area. The proper establishment of succession and suitability plans and policies and the review of the Three Lines of Defence model were also areas of particular attention by the JSTs. Also, the governance of corporate operations mentioned above was an additional focal point.

Regarding market and liquidity risk and IRRBB, the events of the first quarter of 2023 had an impact on the liquidity and interest rate risk management performed by the institutions,

Table 2.3
ON-SITE SUPERVISION OF SIGNIFICANT CREDIT INSTITUTIONS. NUMBER OF ACTIONS

	2023		
	On-site Inspections	Model Investigations	Total
At Spanish credit institutions	19	11	30
Led by the Banco de España	13	7	20
Led by the ECB	3	2	5
Led by other NCAs	3 (a)	2 (b)	5
At credit institutions of other SSM countries	3 (c)	1	4
TOTAL	**22**	**12**	**34**

SOURCE: Banco de España.

a De Nederlandsche Bank, Banco de Portugal and the Commission de Surveillance du Secteur Financier de Luxembourg.
b Banca d'Italia and Banco de Portugal.
c The Banco de España led an inspection in France and participated in the inspections teams at Belgium and Finnish institutions.

and on the supervisory activity carried out by the JSTs. In particular, the crisis of certain banks in the United States and the behaviour of the AT1 instrument market following the crisis of Credit Suisse triggered the monitoring of new metrics, the definition of which was also influenced by the impact of the rise in interest rates on government bond portfolios. The impact of these events on Spanish SIs has been very small, due to their comfortable liquidity situation and the decline in credit, and no market access problems were observed.

Overall, with data up to 15 September 2023, 639 activities were planned by the JSTs for Spanish SIs.

As regards on-site supervision, in 2023 the missions followed a hybrid working model combining visits by inspectors to institutions' head offices with off-site work.

Over the course of 2023, the 19 inspections planned for the year on Spanish significant institutions (Table 2.3) were conducted, in line with the inspections carried out in 2022. In addition, the Banco de España participated in 3 inspections to institutions in other SSM countries.

By risk type, the breakdown of inspections is in line with the supervisory priorities defined for 2023. The supervisory focus continues to be on credit risk (6 inspections), business models (3) and technology risk (2). Moreover, 2 interest rate risk inspections were carried out in 2023 due to concerns about the impact of the rise in interest rates and the crisis in US banks on institutions' risk profile. Also, it is worth noting that 2023 saw the first climate risk inspection at a Spanish institution.

The inspections continued to be conducted with the "campaigns" approach, which accounted for a high percentage of the total number of missions, which favours

uniformity in the review standards and methodology among SSM institutions and countries. In 2023, the relevant campaigns for Spanish institutions were the review of the corporate loan portfolio, business model and interest rate risk.

In 2023, 15 on-site inspection reports were submitted to Spanish SIs, with a total of 156 findings. Credit risk inspections, and interest rate and market risk inspections account for the largest number of findings. The most severe weaknesses identified in relation to credit risk relate to the parameters used by the internal accounting provisioning models, the quality of the databases reviewed and the classification of transactions. In the interest rate and market risk inspections, significant weaknesses were observed in the layers of control over these risks, in the methodology of their assessment models and in the quality of the information received by the management bodies.

As regards internal ratings-based (IRB) model investigations, 11 missions on Spanish significant institutions were undertaken in 2023 (Table 2.3). In addition, the Banco de España led an investigation at 1 institution in Ireland.

By type of risk, in line with previous years, all investigations focused on credit risk models. In terms of content, most of the missions were aimed at reviewing material changes to models emerging from adaptations to the new EBA guidelines (mainly probability of default (PD) and loss given default (LGD) guidelines and the new definition of default) and from the resolution of outstanding obligations from previous missions.

In 2023, 11 Internal Model Investigation (IMI) reports were sent to the Spanish significant institutions, with a total of 253 findings. The most serious weaknesses were concentrated on quantification (both PD and LGD) and on validation and governance processes.

2.4.2 Supervision of less significant institutions, non-EU branches and the Official Credit Institute

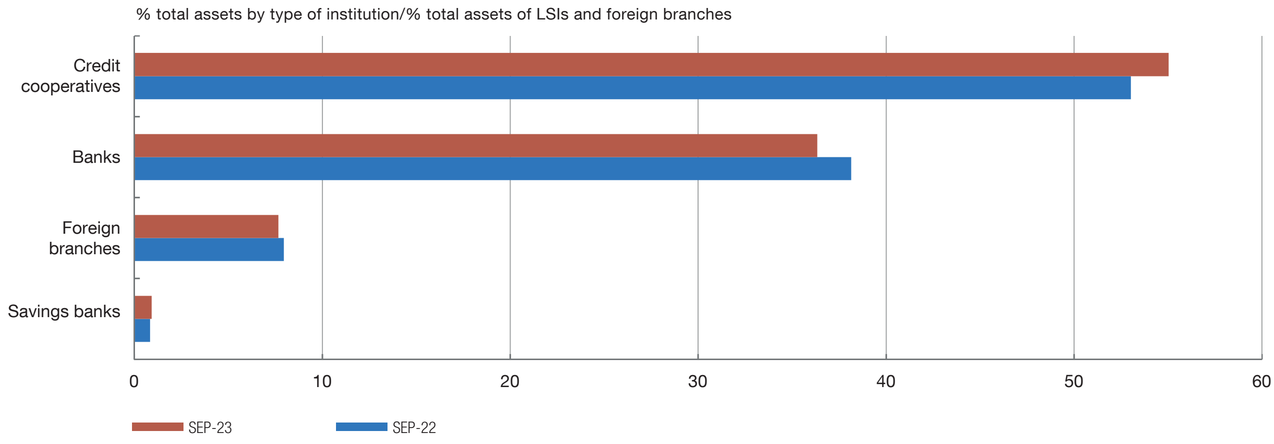
The Banco de España is responsible for the direct supervision of Spanish LSIs, while the ECB is responsible for their indirect supervision in order to ensure the consistent application of high standards and to guarantee the consistency of supervisory outcomes across the SSM countries.

The Banco de España likewise performs supervisory functions on the branches in Spain of LSIs from other SSM countries (and the other EU countries, as the case may be), along with the branches of non-EU credit institutions. Chart 2.11 shows the breakdown of these assets by type of institution. The Banco de España also supervises the ICO.

As mentioned above, the action plan, which details the following year's supervisory activities, is prepared on the basis of the supervisory priorities.

Chart 2.11
WEIGHT OF THE VARIOUS TYPES OF LSIs AND NON-EU BRANCHES

The breakdown of the volume of assets of LSIs has changed, since the percentage of assets from credit cooperatives increased and the percentage of assets relating to banks has decreased.



SOURCE: Banco de España.

Among the ongoing supervision activities, in 2023 regular quarterly monitoring was carried out of the Spanish LSIs and groups of LSIs, with the ultimate objective of detecting potential future problems in the various risks, solvency or business model sustainability.

The SREP follows the SREP methodology for LSIs approved by the ECB and it incorporates all the information obtained in the various ongoing supervision activities. Following the 2023 supervisory exercise, the weighted average P2R required in 2024 for LSIs hardly changed; specifically, it fell by 2 bps. P2R increased for 16 institutions and fell for 11 institutions.

The P2G guidance was updated in the 2023 SREP, albeit with no substantial change in the weighted average level, which increased by 7 bps (it increased for 26 institutions and fell for 15 institutions). To this end, the results of the stress test known as the Forward-Looking Exercise on Spanish Banks (FLESB) (see section 2.4.3), together with the quantitative results of the stress tests performed by the institutions within their internal capital and liquidity adequacy assessment reports, were taken into account.

In addition, the annual letter sent to institutions as a result of the SREP contains other requirements and recommendations arising from the supervisory process carried out during the year. The main weaknesses identified are as follows:

— **Governance.** Weaknesses related to the functioning of the board of directors (board supervision function with room for improvement and deficient minutes) and the composition of the board of directors (lack of gender balance or high average tenure of members); to the remuneration policy and/or its publication; and to improving the content of the internal capital and liquidity adequacy assessment report.

— **Business model.** Weaknesses related to the improvement in results; quality in the design, implementation and monitoring of institutions' strategic plans, and the need to update projections in the event of significant deviations; the effective integration of strategic plans into internal management; the definitive implementation of tools to improve the quality and reporting of profitability by business line; and the improvement in the pricing framework and its effective integration into loan origination processes and systems.

— **Credit risk.** Requirements related to NPL and foreclosure reduction plans, and recommendations to take extra precautions in loan origination and monitoring.

— **Interest rate risk.** Weaknesses related to the need to intensify control and reinforce the monitoring of this risk in institutions where unfavourable interest rate variations could have a greater impact on their solvency or on the recurring margin forecast for the following year; and to the need to update and implement the IRRBB regulatory framework, adapting its means of control to the changes in its business model.

— **Operational risk.** Requirements to all entities arising from the horizontal review of technology risk questionnaires and from the review of critical outsourcing. The two reviews are discussed below.

Also, a review conducted in 2022 of outsourcing processes of critical activities was monitored in 2023, and two horizontal reviews (technology risk and climate risk) were conducted. The findings were incorporated in the annual SREP letter sent to the institutions. Specifically:

— As a result of the horizontal action performed in 2022 on the outsourcing of critical activities, letters were sent to all LSIs so that they assess certain outsourcing arrangements that had not been communicated in the framework of the Banco de España Circular 2/2016 and the EBA guidelines on outsourcing arrangements (EBA/GL/2019/02). In 2023, the notification process was analysed and monitored, and it was concluded that the bulk of institutions had completed the adaptation of their outsourcing agreements. The SREP letters to those that had not done so highlighted the need to complete the adaptation by the end of the first half of 2024.

— A technology risk assessment was conducted based on the responses to a questionnaire developed by the ECB for the LSIs and based on the EBA Guidelines on ICT Risk Assessment under the SREP (EBA/GL/2017/05). The outcome of this assessment was taken into account in the 2023 SREP, and the SREP letters have stressed the need to make progress on the remediation measures for the areas for improvement identified in the questionnaire and to continue to equip themselves with the necessary human resources, technological infrastructure and management procedures, as well as the need to achieve full implementation of cybersecurity measures at all levels of the institution, until they are fully effective, so that the operational risk arising from IT is adequately managed.

— Lastly, the responses to a second climate risk questionnaire submitted by the institutions in January 2023 (the first was sent in 2021) were analysed in order to assess the solidity, exhaustiveness and effectiveness of practices in relation to climate and environmental risks, and the degree of progress made towards meeting the Banco de España's supervisory expectations regarding the risks arising from climate change and environmental deterioration. Areas for improvement focus on climate risk materiality assessments, the definition and incorporation of indicators into the risk appetite framework, the integration of climate risks in their risk management procedures, and the adoption of a global approach to climate risk identification.

The Banco de España has continued to cooperate with other NCAs in the context of a supervisory college of an LSI with subsidiaries in various SSM countries, the parent of which is a non-EU institution. It contributed to joint decisions at that college on capital and liquidity requirements. Also, in its capacity as supervisor of LSIs, the Banco de España has participated in four supervisory colleges[1] and in two resolution colleges[2] for foreign central counterparties (CCPs).

In the case of branches in Spain of institutions with headquarters in other EU Member States, their performance is monitored on a regular basis since they are not subject to prudential or liquidity requirements.

Overall, a total of 727 ongoing supervision actions were carried out on LSIs during 2023.

As regards the on-site supervision plan for LSIs, 11 on-site inspections were commenced or completed in 2023, with a special emphasis on the assessment of credit quality, foreclosed assets, governance and solvency, along with IT-related matters. The main weaknesses detected relate to credit risk, and refer to both quantitative aspects (adequate loan classification and coverage) and qualitative aspects (investment control and monitoring processes), and to governance (functioning of delegated committees, adequate segregation of control functions and insufficient internal audit scope and means).

As a result of the supervisory actions described above that were performed in 2023, the Banco de España sent 93 letters to the LSIs and the ICO. Chart 2.12 provides a breakdown of these letters by type of institution and origin. Of these, 59 related to capital decisions following

1 In accordance with Article 18(2)(c) of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (commonly known as EMIR), the Banco de España participates as the competent authority responsible for the supervision of clearing members established in one of the three Member States with the largest contributions to the default fund of the CCP. The Banco de España participated in three colleges as a voting member and in one as a non-voting member.

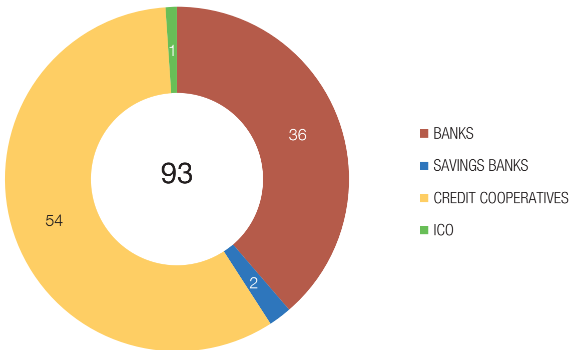
2 In accordance with Article 4(2)(c) of Regulation (EU) 2021/23 on a framework for the recovery and resolution of CCPs, the members of the resolution college shall be the competent authorities and resolution authorities of the clearing members of the CCPs established in the three Member States that, over a one-year period, make the largest aggregate contribution to the default fund. The Banco de España participated in one college as a voting member and in one as a non-voting member.

Chart 2.12

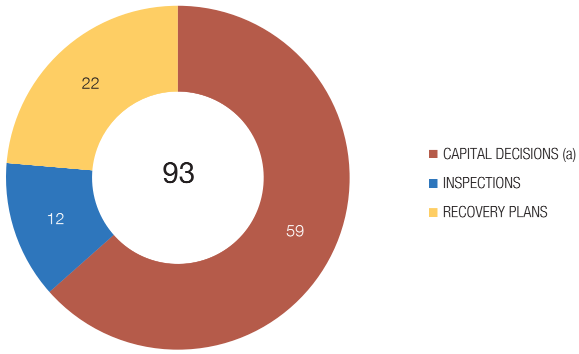
NUMBER OF LETTERS ADDRESSED TO LSI CREDIT INSTITUTIONS

The majority of letters were addressed to credit cooperatives, since this group has the highest number of LSIs, while capital decisions and recovery plans were most commonly at the origin of the letters.

1 BY TYPE OF INSTITUTION (2023)



2 BY ORIGIN (2023)



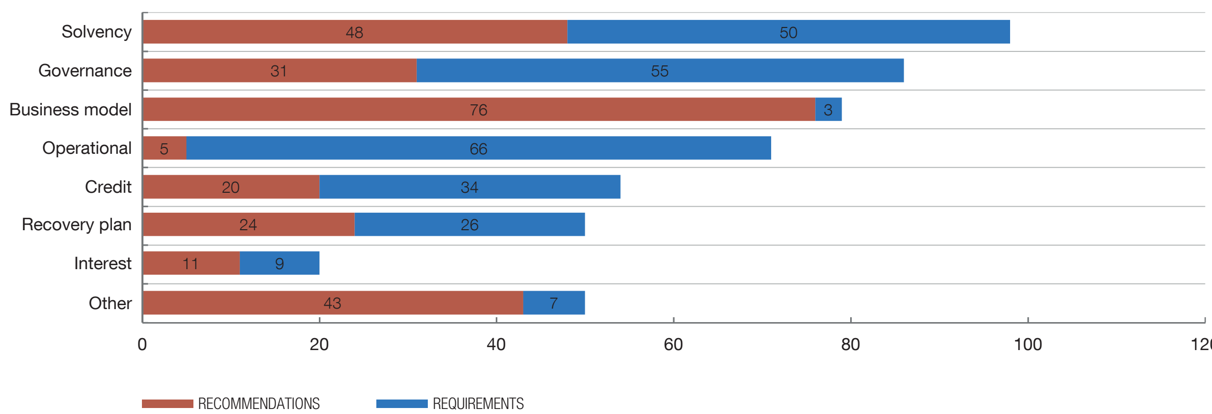
SOURCE: Banco de España.

a The 58 capital decision letters addressed to the 56 LSI institutions or groups (in one case a letter was addressed to a subsidiary of an LSI group in addition to the group itself) and to the ICO.

Chart 2.13

NUMBER OF RECOMMENDATIONS AND REQUIREMENTS NOTIFIED TO CREDIT INSTITUTIONS

By specific areas, the requirements and recommendations on solvency risk, governance and business model stand out.



SOURCE: Banco de España.
NOTE: "Other" contains requirements and recommendations in relation to climate risk and liquidity.

the prior submission of drafts for representations, 22 to recovery plan reviews and 12 to on-site inspections.

Also, Chart 2.13 shows the breakdown by subject matter of the 508 requirements and recommendations contained in the 93 letters sent to credit institutions. As shown in this Chart, the largest number of requirements and recommendations made to LSIs in 2023 relate to the area of solvency (mostly P2R and P2G requirements included in capital decisions); to the area of governance (both in capital decisions and inspections); to the area of business models (in capital decision letters); and to the area of operational risk (capital decisions), the main conclusions of which are detailed above. Most of the requirements arising from the inspections related to governance and credit risk, in equal measure, as explained above.

On a quarterly basis, within the LSI monitoring framework, the situation of the requirements and recommendations not yet complied with by each institution is assessed and communicated to the Executive Committee within the framework of compliance with the supervisory plan.

2.4.3 Stress tests

The EBA is responsible for coordinating the European stress tests, which are conducted every two years. 70 groups of European credit institutions, representing approximately 75% of the assets of the EU banking sector, participated in the 2023 stress test. As compared to the previous year (in 2021), 20 groups were added to the sample, which represents an increase of around 5% in terms of asset volume. In the case of Spain, 8 groups participated: Abanca, Bankinter, BBVA, Caixabank, Kutxabank, Sabadell, Santander and Unicaja. The ECB, in turn, carried out a test, with criteria consistent with those applied by the EBA, on a further 41 significant institutions under its supervision, including Ibercaja and Banco de Crédito Social Cooperativo.

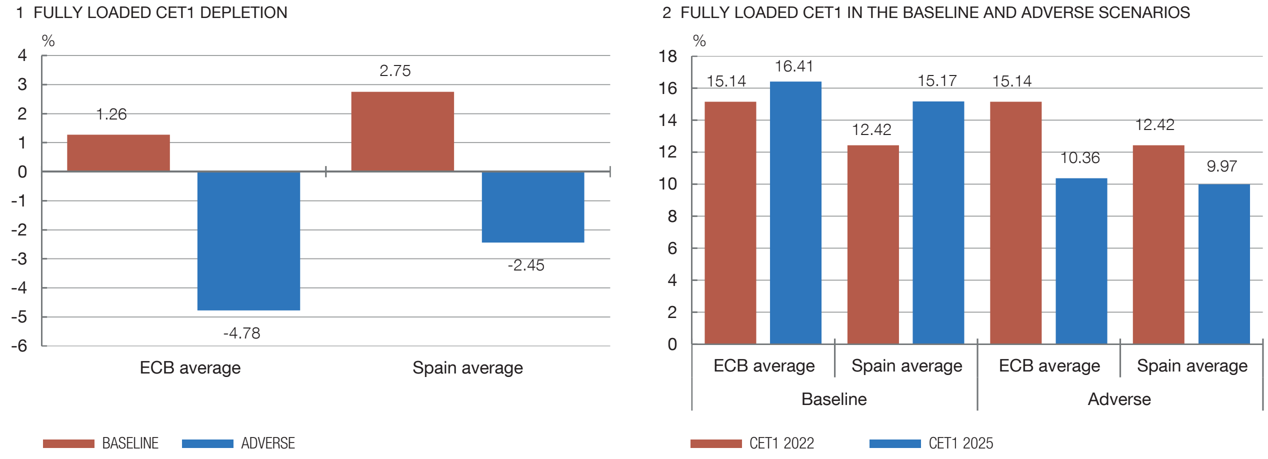
The design of this year's adverse scenario was characterised by a sharp contraction in economic activity, caused by disruptions to global supply chains due to increased geopolitical tensions, aggravated by a new outbreak of COVID-19 infections. These disruptions also made inflation higher and more persistent, leading to high market interest rates. This was precisely the main difference between the adverse scenario and the scenario used in 2021.

Charts 2.14.1 and 2.14.2 show that the impact of the adverse scenario on fully loaded capital for all the institutions supervised by the ECB was 478 bp, as compared to 245 bp for the Spanish institutions. This means that the 272 bps higher CET1 ratio of the SSM bank average at the starting point in 2022 compared to Spanish institutions (15.1% against 12.4%) becomes only 39 bps stronger (10.4% as compared to 10%) at the end of the exercise at end-2025.

These results reflect Spanish institutions' resilience in the adverse scenario, with satisfactory capital levels despite the greater severity. In this scenario, the new resources generated by Spanish banks are positive (6.2%) thanks to the increase in the interest margin, but cannot offset the significant loan impairment losses (7.4%) or the other negative impacts (1.3%).

As in previous years, no minimum capital thresholds were set. However, the outcome of the adverse scenario served as the basis for determining P2G. In addition, qualitative aspects of the conduct of the exercise are taken into account in the supervisory review and assessment process and, therefore, they may have influenced the P2R requirements, mainly in governance and operational risk.

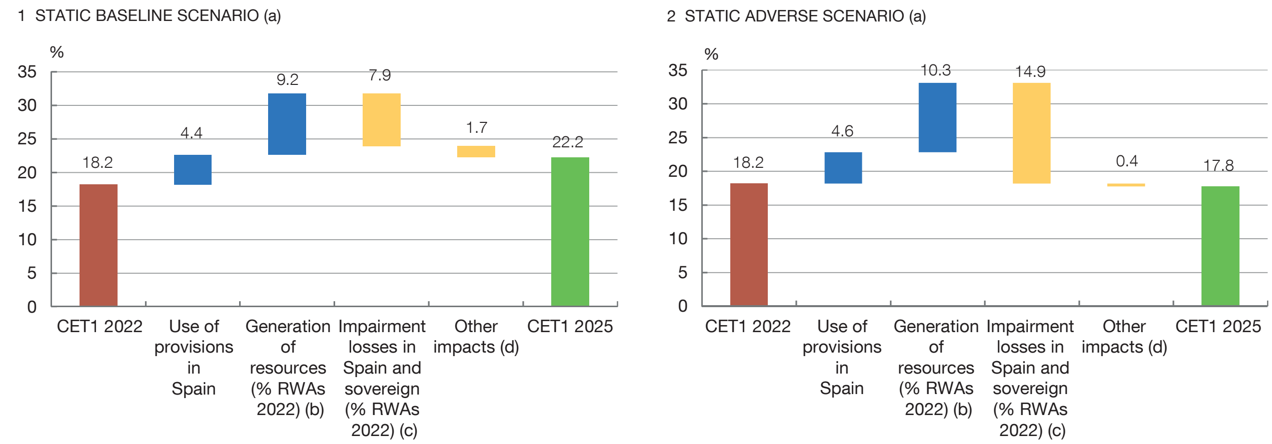
Chart 2.14
2023 EUROPEAN STRESS TEST



SOURCE: EBA, produced by Banco de España.

Chart 2.15
LSI STRESS TESTS. RESULTS

The results of the FLESB stress test for LSIs shows that there is a 4 pp increase in their CET1 ratio in the baseline scenario, while there is a 0.4 pp decrease in the adverse scenario.



SOURCE: Banco de España.

a The yellow (blue) colour of the bars indicates a negative/positive contribution of the item corresponding to the change in the CET1 ratio at the horizon end of the forward-looking exercise (2025) as compared to the beginning of the exercise (2022).
b The generation of loss-absorbing resources is determined by net operating income in Spain.
c Impairment losses on loans and foreclosed assets in Spain, and the impact on capital of the potential impairment of institutions' sovereign exposures.
d Other consolidated profit and loss, tax and exchange rate effects, profit distribution and changes in RWAs.

The Banco de España conducts annual stress tests of LSIs[3] with the aim of measuring institutions' capacity to cope with potential macroeconomic and financial risks and to feed the SREP and, in particular, the P2G estimate. These tests are conducted in the same framework and under the FLESB tool, which is mentioned in Chapter 3.

3 These stress tests are conducted in accordance with Article 55(5) of Law 10/2014 on the regulation, supervision and solvency of credit institutions.

The aggregate results of the test, with the baseline and adverse scenarios of that section which use the static balance sheet method recommended by the ECB, point to an increase in the CET1 ratio of 4 pp in the baseline scenario and a decrease of 0.4 pp in the adverse scenario (Chart 2.15). In the baseline scenario, the generation of new loss-absorbing resources (9.2% of RWAs) and the use of provisions (4.4%) more than offset impairment losses (7.9%) and the other impacts (-1.7%). In the adverse scenario, the new resources generated are positive (10.3%) thanks to the increase in the interest margin favoured by the interest rate rise; however, this effect, together with the use of provisions (4.6%), does not offset the negative effect of the other impacts (0.4%) and the significant impairment losses (14.9%).

The aggregate solvency of all the LSIs in both scenarios would be high and above regulatory requirements.

2.4.4 Supervision of covered bonds and securitisations

The supervisory powers over covered bonds were attributed to the Banco de España by Royal Decree-Law 24/2021.[4] This new supervisory regime is complemented by the designation by the issuing institutions of a cover pool control body, which performs the ongoing monitoring of the cover pool.

Royal Decree-Law 5/2023 of 28 June 2023 introduced significant amendments in this matter, including, inter alia, those relating to the assessment of cover assets, loan exits from the cover pool and the authorisation of loan restructurings by the control body, and to the appointment and sanctioning regime of that control body.

At December 2023, there were 19 Spanish credit institutions issuing covered bonds under the scope of this supervision. These institutions have designated a total of 5 commercial companies as cover pool control bodies. This new regulatory regime strengthens the activity of a market that has been widely used by Spanish institutions in recent years.

In 2023, both individual monitoring of each of the issuing institutions and a horizontal analysis were carried out. Issuing institutions submit to the Banco de España, on a quarterly basis, the confidential returns relating to covered bonds provided for in Circular 1/2023, which entered into force on 31 March 2023. Both the issuing institutions and control bodies have adequately adapted to the new covered bond regime. In this respect, no weaknesses were noted in the formation of the cover pools, which comply with all legal requirements in terms of over-collateralisation, loan-to-value (LTV) ratio and liquidity cushion. The implementation phase is considered completed and on-site inspections on this matter are planned to start in 2024.

4 This regulation transposed Directive (EU) 2019/2162, thereby establishing a harmonised minimum regime in the EU with regard to the conditions for the issue and characteristics of this type of instrument, with the aim of promoting the unified development of these markets.

In addition, among its supervisory functions, the Banco de España must authorise the programmes that include the characteristics of the covered bonds issued under it. In this regard, over the course of the year, the Banco de España authorised one new programme, the extension of the term of another programme, the increase in the amount of three programmes and the termination of another programme.

At the end of 2023, there were 27 authorised covered bond programmes, with an aggregate maximum amount of EUR 421 billion, covering both issues outstanding at that date and issues subsequent to the term of the programme and up to the maximum authorised amount.

At December 2023, there were 218 outstanding covered bonds on the Spanish covered bond market, with a nominal value of around EUR 213 billion, of which 89% corresponded to mortgage covered bonds, 6% to public sector covered bonds and 5% to internationalisation covered bonds. Total covered bond issuance in 2023 amounted to EUR 25.3 billion, while repayments amounted to EUR 22.8 billion.

Lastly, in compliance with Royal Decree-Law 24/2021, the Banco de España discloses and periodically updates on its website the list of authorised issuing institutions and of covered bonds issued under authorised programmes.

Also, in accordance with Law 5/2015 of 27 April 2015 on the promotion of business financing, as amended by Law 6/2023 of 17 March 2023 on Securities Markets and Investment Services, in 2023 the Banco de España assumed the supervision of the specific framework for simple, transparent and standardised (STS) securitisation, provided for in Regulation (EU) 2017/2402, when the issuers of these instruments are credit institutions or other institutions under the supervision of the Banco de España.

In the context of this supervision, institutions have submitted to the Banco de España information in relation to STS securitisations existing at 2023 year-end. 54 notifications of STS securitisations were received, of which 35 related to significant credit institutions. All of them have been notified to the European Securities and Markets Authority in accordance with the procedures established for this purpose and, pursuant to Article 28 of Regulation (EU) 2017/2402, they have used the service of an authorised third party certifying that the STS criteria have been respected. The Banco de España has initiated a review of these transactions to verify compliance with the STS criteria, as set out in Regulation (EU) 2017/2402.

Also derived from Regulation (EU) 2017/2402, the Banco de España has to supervise compliance with certain requirements that any securitisation must meet, relating to risk retention, transparency of information, the ban on re-securitisation and credit granting. In this case, the institutions under the scope of the supervision of the Banco de España are the LSIs, as well as the other institutions subject to the supervision of the Banco de España in accordance with sectoral regulations. As regards the SIs' securitisations, this review falls under the remit of the ECB.

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For this purpose, the institutions also submit information to the Banco de España, following the established procedure. In 2023, 19 notifications were received in relation to LSIs and specialised lending institution (SLIs) securitisations, of which 14 qualified as STS.

2.4.5 Anti-money laundering and countering the financing of terrorism

The Banco de España's powers in the area of anti-money laundering and countering the financing of terrorism (AML/CFT) are confined to the supervision of certain obligations related to due diligence, internal control and reporting, at the institutions subject to AML/CFT regulations within its scope of supervision.[5] These supervisory powers are exercised within the framework of the provisions of Spanish legislation and the agreement entered into with the Commission for the Prevention of Money Laundering and Monetary Offences (CPMLMO) in 2021 for the coordination of their respective supervisory and inspection activities, particularly through close cooperation with its two bodies, the Secretariat of the CPMLMO and SEPBLAC, and with the National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds (DGSFP). This cooperation allows supervisory synergies to be exploited and contributes to institutional efficiency.

In 2023 supervisory cooperation continued to advance. In this respect, together with SEPBLAC, the Banco de España completed the update of the assessment methodology for money laundering and countering the financing of terrorism (ML/CFT) risk at credit institutions and updated the ML/CFT risk profile of credit institutions established in Spain, in accordance with the aforementioned methodology. This profile is an essential element for the annual preparation of the Joint Inspection Plan, which follows a risk-based approach. Also, the Banco de España continued to work on the development of supervisory criteria and procedures in coordination with the Secretariat of the CPMLMO, SEPBLAC, the DGSFP and the CNMV.

Over the course of 2023, the Banco de España completed the following inspections (all of which commenced in 2022): 2 general actions in relation to AML/CFT obligations, relating to one LSI and one SI; a specific inspection on one SI's internal control systems for the activity carried out by its branches and subsidiaries abroad, and, jointly with SEPBLAC, 15 thematic reviews of foreign exchange activity (at 9 SIs, 5 LSIs and 1 branch of an EU institution).

In relation to these thematic reviews of foreign exchange activity, it can be concluded that, in general, internal policies and regulations are adequate; in particular, these include measures for the identification of the customer and, in the case of legal entities, of the beneficial owner, which are in line with current regulations. The implementation of due diligence measures for this type of customer is generally adequate, although institutions have been required to further improve the alerts related to foreign exchange activity.

5 Credit institutions, branches of foreign credit institutions, SLIs, mutual guarantee societies (MGSs), payment institutions (PIs), electronic money institutions (ELMIs) and currency-exchange bureaux.

As regards general inspections, the main weaknesses identified relate exclusively to the implementation of due diligence measures, in particular the ongoing monitoring of business relationships. Room for improvement was also observed in the detection, analysis and reporting of suspicious operations, and in the allocation of technical and human resources. In this regard, institutions have been required to strengthen internal control systems, including the implementation of due diligence measures and the monitoring of customers and suspicious transactions, and to increase the resources allocated.

Lastly, the inspection of foreign activity control systems identified weaknesses in relation to the implementation of corporate policies and procedures and the supervision model of subsidiaries and branches, requiring institutions to strengthen the oversight of their groups' foreign activity. Also, there were recommendations for the implementation of measures ensuring that a global view is obtained on customers operating in several jurisdictions.

Taking into account the findings of these inspections, in the second half of 2023 the Banco de España initiated and concluded four inspections of currency-exchange bureaux. Lastly, a general inspection of one SI commenced at the end of 2023.

At the international level, the Banco de España continued to cooperate closely with other supervisors and to participate in international AML/CFT supervisory fora. In particular, in addition to maintaining bilateral cooperation relations with AML/CFT supervisors in other countries, the Banco de España and SEPBLAC jointly organised the supervisory colleges for 6 Spanish credit institutions and 8 Spanish PIs, and participated in 70 AML/CFT supervisory colleges of other European institutions.

Lastly, in regulatory matters, the Banco de España provided technical support to the negotiations on the EU's AML/CFT legislative package of July 2021.[6] This package seeks, among other things, the approval of a regulation for the creation of the European Anti-Money Laundering Authority (AMLA), with direct and indirect supervisory functions over regulated institutions, and a more harmonised regulatory framework in the EU, which will include both a new European regulation that is directly applicable to regulated institutions and a sixth AML/CFT directive.

2.4.6 Common procedures, suitability and other procedures

Common procedures are those relating to the authorisation to perform the activity of credit institutions, the withdrawal of such authorisation and the acquisition of qualifying holdings. They are set out in ECB Regulation (EU) No 468/2014 establishing the framework for cooperation within the SSM between the ECB and NCAs. In these procedures, for Spanish institutions, the Banco de España makes an initial assessment and formulates a draft decision

6 https://ec.europa.eu/commission/presscorner/detail/es/ip_21_3690

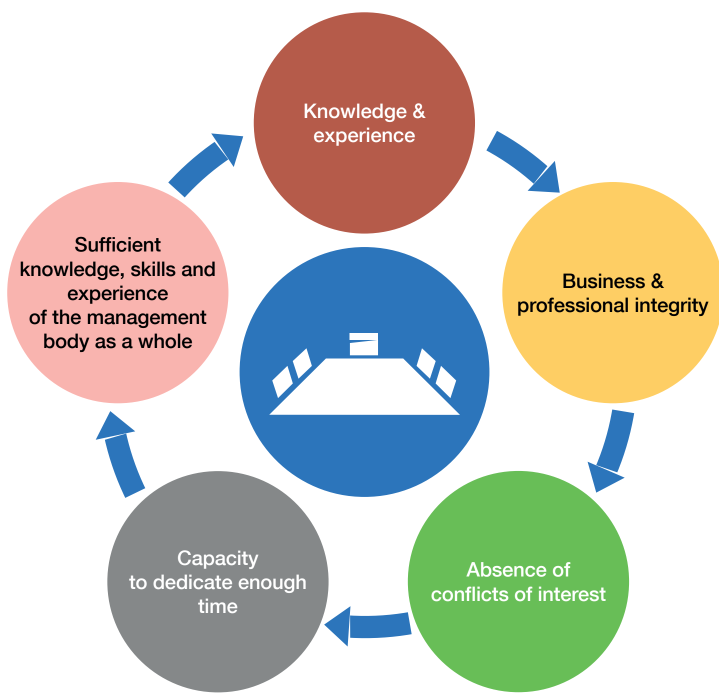
Table 2.4
PROCEDURES IN RESPECT OF CREDIT INSTITUTIONS INVOLVING THE BANCO DE ESPAÑA

	Total number
Qualifying holdings, merger, spin-off and other significant acquisitions	6
Cross-border activity of Spanish credit institutions	91
Branches in the EU	15
Branches in third countries	0
Freedom to provide services	76
Representative offices	0
Cessation of business	0
Loans to directors & senior officers	16
Suitability of directors & senior officers (a)	207
Procedures relating to capital	100
Amendments to articles of association	26
Climate change	57
Communications with other supervisory authorities or institutions	7
Other procedures	85
TOTAL	595

SOURCE: Banco de España.

a Includes 17 suitability assessments regarding mixed financial holding companies.

Figure 2.3
SUITABILITY REQUIREMENTS ASSESSED FOR DIRECTORS WITHIN THE SSM



SOURCE: Banco de España.

for each specific case. Subsequently, on the basis of this proposal and any additional work it deems appropriate, the ECB adopts a definitive decision. Noteworthy among the rest of the procedures is the suitability procedure.

Table 2.4 details the common procedures and the rest of the procedures on credit institutions in which the Banco de España has participated.

Figure 2.3 offers a visual summary of the determining criteria in the assessment of SSM directors.

2.5 Supervision of institutions other than credit institutions

The Banco de España has exclusive microprudential supervisory powers over the following institutions that provide financial services or carry out activities related to the financial system: SLIs, mutual guarantee societies (MGSs), re-guarantee companies, appraisal companies, PIs, exempt PIs, account information service providers, ELMIs,[7] currency-exchange bureaux, Sareb (the asset management company for assets arising from bank restructuring)[8] and banking foundations.[9] Table 2.5 shows the number and performance of these institutions other than credit institutions.

The legal basis under which the Banco de España supervises these institutions and the approach to the tasks differ from case to case. Although the weight of these institutions in the financial system is not comparable to that of credit institutions, an effective regulatory and supervisory model of these institutions promotes the fluidity of financial intermediation mechanisms and generates a climate of trust in financial institutions.

The Banco de España is the competent authority for registering, granting and withdrawing the licenses of the various types of payment institutions and electronic money institutions provided for in Royal Decree-Law 19/2018, and SLIs which provide payment services (SLI-PIs) or which issue electronic money (SLI-ELMIs) and currency-exchange bureaux, and for the official recognition of appraisal companies.

7 As regards the supervision of PIs and ELMIs, it should be noted that the Banco de España has distributed this supervision internally between the Directorate General Banking Supervision and the Directorate General Operations, Markets and Payment Systems. The Directorate General Banking Supervision, to simplify matters, deals with the supervision of solvency, the shareholder structure and the business model from a profitability perspective, while the Directorate General Operations, Markets and Payment Systems deals with the supervision of the safeguarding of funds and the operational aspects of payment service provision.

8 The Banco de España supervises fulfilment of Sareb's sole corporate purpose, in order to identify deviations therefrom that jeopardise the attainment of Sareb's overall statutory objectives.

9 Law 26/2013 of 27 December 2013 on savings banks and banking foundations confers on the Banco de España control of compliance with certain rules related to the influence of the banking foundation over the sound and prudent management of the investee credit institution, in the event that the foundation holds an ownership interest of, at least, 30% of the share capital of the credit institution or which allows it to exercise control. This control refers to the submission for approval by the Banco de España of management protocols and annual financial plans.

Table 2.5
REGISTER OF INSTITUTIONS OTHER THAN CREDIT INSTITUTIONS

Data at 31 December

	2021	2022	2023
SLIs	23	24	25
SLI-PIs	9	9	9
Branches of financial institutions subsidiaries of EU credit institutions	1	1	1
MGSs and reguarantee companies	19	19	19
Appraisal companies	32	32	32
Currency-exchange bureaux (a)	16	16	15
PIs	49	52	50
PIs exempt under Article 14 of Royal Decree-law 19/2018	9	10	14
Payment service providers excluded under Article 4 of Royal Decree-Law 19/2018	15	18	23
Account information service providers	1	3	4
ELMIs	9	10	10
Branches of EU PIs	7	9	8
Branches of EU ELMIs	3	4	6
TOTAL	**193**	**207**	**216**

SOURCE: Banco de España.

a Not including establishments authorised only to purchase currency using euros.

Also, the Banco de España is tasked with issuing the mandatory report on the authorisation of SLIs, MGSs and re-guarantee companies, the granting of which is the prerogative of the Ministry of Economy, Trade and Business.

With regard to applications for authorisation and registration of new payment service providers, noteworthy is the relatively low number of applications for the extension of activity compared to the total number of authorisation and registration applications. As a result, the observed trend leads to the consolidation of a payment service provider ecosystem which has ever more participants and, therefore, is increasingly heterogeneous, with an associated increase in the number of institutions to be supervised.

The number of PIs and ELMIs increased from 49 in December 2018 to 78 at the end of 2023 (50 PIs, 10 ELMIs, 14 small payment institutions (SPIs) that are exempt pursuant to Article 14 of Royal Decree-Law 19/2018, and 4 aggregators). In line with this increase, the number of payment service providers excluded under Article 4 of Royal Decree-Law 19/2018[10] continues to grow.

Specifically, with regard to authorisation procedures for new specialised payment service providers, a total of 15 requests for assessments of payment service provision were received, of which 7 were procedures to request authorisation to operate as a PI, 5 to operate as an

10 The payment service providers excluded under Article 4 of Royal Decree-Law 19/2018 that are included in Table 2.5 are subject to a separate registration regime in the Banco de España and only certain regulatory provisions of Royal Decree-Law 19/2018 are applicable to them.

ELMI and 3 to benefit from the partial exemption regime established in Article 14 of Royal Decree-Law 19/2018.

In addition, 19 new license authorisation processes are in progress for the various types of payment institutions, which will lead to a further increase in the number of institutions in this sector.

It is worth noting that in 2023, in order to streamline authorisation and registration procedures, the informative guide on these processes, as well as certain forms, was updated and can be consulted at the Banco de España's Sede Electrónica (Electronic Headquarters). Also, the Banco de España is a member of the electronic notification system, Single Enabled Electronic Address *(Dirección Electrónica Habilitada Única)*, to offer interested parties the opportunity to send communications and notifications by electronic means.

The pre-application process for authorisation or registration was also improved, in such a way that it offers applicants the possibility of holding a meeting before formally submitting the application to discuss the most relevant aspects of the project and resolve doubts about the procedure.

In 2023, 281 ongoing off-site supervision actions were carried out by various means: periodic monitoring, external audit report reviews and other actions, as detailed in Chart 2.16. These monitoring activities carried out through the returns and the alert system make it possible to detect situations of non-compliance with regulatory requirements, such as the non-compliance with minimum capital requirements in the area of payment institutions discussed below, and any significant deviations in financial behaviour.

Also, 2023 saw the commencement of an inspection of one MGS, one ELMI and one appraisal company. For 2024, inspection visits are planned to two appraisal companies, one ELMI, one PI and one MGS. In addition, as in 2022, a capital decision was sent to one SLI in 2023, justified by the institution's importance.

Similarly, in 2023 further 2,693 procedures were performed within the remit of the supervisory powers over these institutions, as detailed in Table 2.6.

In relation to compliance with PI and ELMI capital requirements, oversight is conducted through the information collected from these institutions by means of ad hoc templates that they have been submitting since 2020 until the development of a prudential circular that allows for regular reporting on their solvency situation. As a result of this oversight, from 2020 to date, 27 situations of non-compliance with capital requirements have been detected, requiring the injection of capital by their shareholders.

These capital needs generally arise from two very different situations: on the one hand, the limited generation of capital by some institutions in the sector, which does not cover their own business expectations, and, on the other, the limited solvency buffer with which some of these institutions operate, which hinders the absorption of the higher capital requirements arising from increased activity or from greater investment in technological systems.

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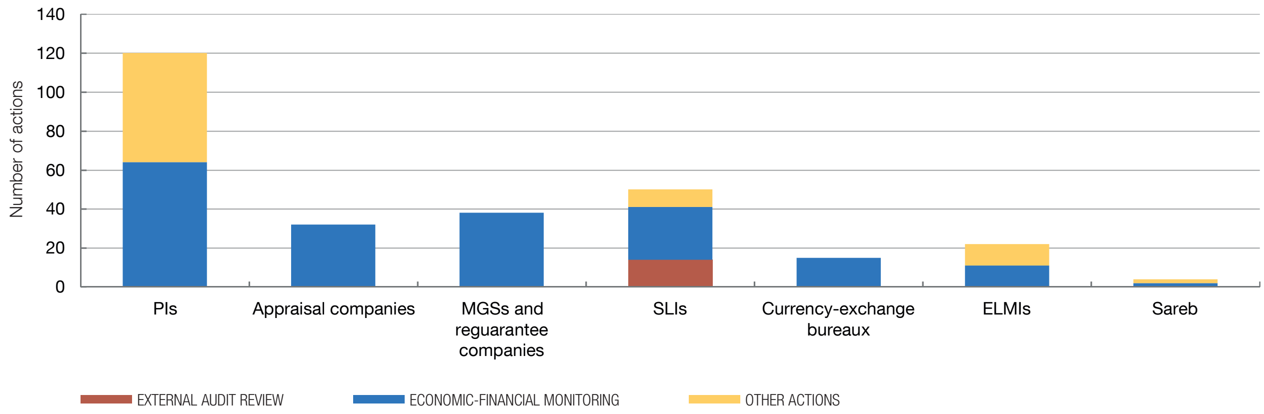
Chart 2.16
NUMBER OF ONGOING OFF-SITE SUPERVISORY ACTIONS AT OTHER INSTITUTIONS



SOURCE: Banco de España.

Table 2.6
OTHER PROCEDURES PERFORMED BY THE BANCO DE ESPAÑA ON OTHER INSTITUTIONS

Number of procedures in 2023

	PIs	ELMIs	SLIs	MGSs	Appraisal companies	Currency-exchange bureaux	Sareb	Banking foundations	Total other institutions
Qualifying holdings, mergers, spin-offs and other significant acquisitions	9	6	6			1			**22**
Cross-border activity of Spanish credit institutions (a)	2,400	4	1						**2,405**
Branches in the EU	8	1	1						**10**
Branches in third countries									**0**
Freedom to provide services	194								**194**
Agents	2,198	3							**2,201**
Cessation of business	6								**6**
Suitability of senior officers	61 (*)	37	33	42	21	3			**197**
Procedures relating to capital	3					1			**4**
Amendments to articles of association	7	3	3	1					**14**
Authorisation of management protocol and financial plan								8	**8**
Communications with other supervisory authorities or institutions						30			**30**
Other procedures			5			2			**7**
TOTAL									**2,693**

SOURCE: Banco de España.

a Each daily notification per recipient country and institution is deemed a procedure.
(*) Includes 2 hybrid payment institutions' senior officer suitability procedures.

In addition to the high number of register entries for PI agents (2,201), noteworthy are the supervisory procedures in the PI and ELMI area, with 15 procedures for qualifying holdings, mergers, spin-offs and other acquisitions. It is also worth mentioning these institutions' senior officer suitability processes, which amounted to 197 procedures in 2023 and were carried out in most of the sector, the largest number being PIs.

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Section 2.6 describes the Banco de España's oversight of the operational aspects of the provision of payment services, including institutions' security and fraud control. Further below, in section 2.7, additional information is provided on the appraisal company sector and its supervision.

2.6 Supervision of payment service providers

In 2023, a major part of the supervisory activity of PIs and ELMIs consisted of reviewing compliance with the guarantee and protection requirements for payment service users' funds; this activity will be continued next year.

With regard to the reporting of major operational or security incidents related to payment service provision, 58 incidents were reported in 2023, which were generally due to failures in the systems or processes implemented by the institutions. Noteworthy are two incidents which affected the same group of institutions and another two incidents which affected a significant number of payment service providers, as they originated in a card payment processor.

The analysis of the six-monthly evolution of fraud data seems to confirm the growing impact and importance of digital fraud with respect to total fraud in payment transactions, especially in transfer and card transactions. The most common type of digital fraud includes most notably fraudsters' manipulation of payers in order to obtain their banking codes or authorisation for fraudulent transactions; to this end they use social engineering techniques, such as phishing (online), vishing (via voice calls) or smishing (via SMS). Moreover, the evolution of data also confirms that the implementation of the use of strong customer authentication (SCA) techniques on initiation of card payment transactions has had a beneficial impact on fraud containment. In addition, the EBA, together with the NCAs, conducted a review process of the fraud information reported by the institutions.

Under the framework of Delegated Regulation 2018/389, approval was granted for four requests submitted by three payment service providers to apply the SCA exemption provided for legal entities initiating electronic payment transactions through certain payment processes or protocols only available to payers who are not consumers. These decisions were issued on particular payment solutions, designed and managed entirely and exclusively by the corresponding payment service providers and mainly related to payment cards issued for specific purposes.

As regards the proper functioning and performance of the specific interfaces maintained by the account servicing payment service providers, as in previous years, the problems reported by the so-called "third party payment service providers" have been managed and monitored in order to resolve them. These problems have mainly consisted of shortcomings in the information provided on the status of payment transactions initiated through the above-mentioned interfaces, one-off outages and deteriorations in the interface performance and additional frictions for payment service users as compared to the experience offered by other remote payment account access channels.

A total of 24 communications were received and analysed regarding the delegation of operational functions from PIs and ELMIs, most of which were related to critical functions, which represents an increase of more than 70% with respect to the previous year. In addition, 13 files have also been reported on requests for the exclusion from the scope of application of the payment services regulation of certain payment instruments that can be used only in a limited way.

Lastly, in the area of international coordination in the supervision of payment service provision, there have been varying degrees of participation in the implementation and application of the payment service provision regulation.

2.7 Supervision of appraisal companies

The officially recognised appraisal company sector currently comprises 32 companies One characteristic of the sector is its concentration, since 5 companies or groups of companies issued appraisals accounting for 61% of the total volume of appraisals in 2022, while at the other extreme, the 12 appraisal companies with an individual market share of less than 1% together only issued 4% of this amount. A significant part of the business of appraisal companies continues to be contributed by credit institutions which, since 2013, can no longer hold shares in appraisal companies, a measure that was adopted to foster the independence of the sector.

The choice of which companies are to be inspected is based on both size and risk profile. In order to determine the risk profile, all available information on the companies is used, including the results of statistical tools that analyse various parameters of the valuations issued by the appraisal companies in the previous year, and, to this end, specific databases are requested annually from the appraisal companies. Since 2018, on-site inspections have been carried out at several appraisal companies which, together, account for a 79% market share of the total volume of appraisals, and this figure will reach 87% by the end of 2024.

In 2022, a letter was sent to the two associations of valuation companies and meetings were held with them to inform of the main weaknesses that had been detected most frequently in inspections with the aim of improving the application of valuation regulations and compliance with official recognition requirements. In particular, emphasis was placed on the need to have sufficient technical and human resources to carry out the control of the appraisals issued; to remedy shortcomings in the application of valuation methods; and to improve the content of appraisal reports, which, in the case of the comparison method, were focused on the content of market information, the characteristics of witnesses and the process of valuation homogenisation.

2.8 Compliance with vetted access to activity and name reservation

Under Spanish legislation, several financial activities are subject to vetted access to activity, i.e. they can only be carried out by the legal entities and individuals legally authorised to do so. The Banco de España's functions include overseeing compliance with this legislation, taking action on those seeking to break into the financial market without meeting the conditions of access, either by conducting activities legally restricted to credit institutions, payment service providers or other types of institutions supervised by the Banco de España, or through the use of generic names restricted to those institutions or any other name that may confuse the public.

In 2023, 14 supervisory actions were performed in relation to legal entities and a further one was performed in relation to an individual that may have been carrying out activities restricted to credit institutions and/or currency-exchange bureaux without authorisation or simply making undue use of a name pertaining to supervised institutions; these actions could lead to the adoption of penalties.

In the area of payment services, the analysis commenced in 2023 of eight cases of possible non-compliance with the vetted access to activity established in Article 5 of Royal Decree-Law 19/2018 of 23 November 2018 on payment services and other urgent financial measures. Most of these cases are caused by certain formal irregularities detected in the activity of commercial establishments which, in reality, operate as agents or distributors in Spain of payment service providers; innovative business models, that are not always an easy fit within the regulations; as well as institutions which depend on other payment service providers to carry out their activity.

At the end of November 2023, the Executive Commission of the Banco de España assigned to the General Secretariat the responsibilities for the supervision of vetted access to activity and name reservation, previously carried out by the Directorate General Banking Supervision and the Directorate General Operations, Markets and Payment Systems. Thus, the General Secretariat, through the new Financial Fraud Prevention Unit, is the area currently responsible for carrying out the aforementioned supervisory functions and for submitting the corresponding reports and proposals on this matter to the Banco de España's governing bodies.

2.9 Application of financial technology innovation to supervisory functions. Sandbox: controlled digital innovation testing space

The Banco de España considers that its modernisation is essential for it to become a more efficient, flexible and innovative institution and, therefore, the need to boost technological innovation is included in its 2024 Strategic Plan.

In the area of supervision, the term "SupTech"[11] has become popular in recent years to refer to the use of innovative technology (e.g. machine learning and big data) by supervisory authorities to support their work. In this same area, the Banco de España has been operating for decades with multidisciplinary supervisory teams comprising inspectors, supervisory experts, IT auditors and modelling experts accustomed to bulk data processing, which puts it in a good position to address the above-mentioned boost in the supervisory field.

Consequently, one of the paths that will boost technological innovation is the incorporation of new technologies into supervisory activity; in order to achieve this, among other things, a roadmap was designed that runs until the end of 2024 and which has been published on the Banco de España's blog. This roadmap presents the following four major blocks of activities, which are in turn interrelated:

i) **In-house creation of SupTech tools.** Box 2.7 provides a number of examples of internal technological innovation developments applied to supervision (SupTech).

ii) **Active participation in the SupTech initiatives carried out in the SSM.** The use of SSM tools is fostered, and internally developed tools are shared with the rest of the SSM. Of particular note is that fact that the Banco de España has been designated as SSM SupTech centre.

iii) **Fostering a culture of innovation.** An internal SupTech forum was set up in the DG.SUP and there is intensive collaboration with other areas, especially with the Information Systems Department.

iv) **Boosting training in data science. To this end, courses given by DG.SUP** staff have been incorporated into the Banco de España's extensive training catalogue. These courses are occasionally open to staff from other SSM supervisory authorities or from the Association of Supervisors of Banks of the Americas.

Also, in line with the priority given to this area, the SupTech function was included in the external evaluation programme, that was conducted by a team of independent international experts, commencing in the first quarter of 2023. The strengths highlighted by the evaluators are the significant progress made in recent years: they stress the support of senior management and emphasise some aspects that put us ahead of other central banks and financial authorities, such as having an explicit strategy and roadmap, and a formal process for the identification, exploration and development of potential SupTech tools.

In terms of possible areas for improvement, a more effective deployment of SupTech tools is suggested, integrating them into the supervisory process and strengthening the dedicated resources and development activities to acquire the required skills, as well as developing the

11 Simone di Castri, Stefan Hohl, Arend Kulenkampff and Jermy Prenio. (2019). "The suptech generations". FSI Insights, 19. https://www.bis.org/fsi/publ/insights19.htm.

necessary digital mindset among supervisory staff. They also suggest further close coordination with the SSM on the development and implementation of tools. Moving forward, they propose exploring other tools for dealing with the changing landscape of the financial system. These suggestions undoubtedly point to the way for further growth and serve as a guide for drafting the next roadmap.

The controlled testing space,[12] known internationally as the "regulatory sandbox", allows for the testing of innovative projects for the financial system under the monitoring of the competent financial authorities. The benefits of this instrument for project promoters include the possibility of knowing what the supervisory expectations are, identifying the existence of regulatory barriers or knowing whether they need to apply for a licence or authorisation for the subsequent exercise of the activity. Moreover, it allows supervisory authorities to understand the state of the art of technology-based financial innovation and the impact that the projects could have on the Spanish financial system.

This year there are two authorised periods for the submission of applications. On 20 January 2023[13] the General Secretariat of the Treasury and International Financing approved the resolution announcing the fifth call and set the application submission period between 1 March and 12 April 2023. A total of 11 projects were received. Of these, four of the five projects that were assigned to the Banco de España received a favourable rating. The sixth call was announced by resolution of 28 July 2023,[14] with an application submission period between 1 September and 13 October 2023. In this call, there was a slight decrease in the absolute number of projects submitted, with a total of seven projects. Of these, two were assessed by this institution, but were not finally admitted because they did not meet the access requirements set out in Law 7/2020 of 13 November 2020 for the digital transformation of the financial system.

Throughout the year, projects from five different calls coexisted at various stages. Thus, tests of the ContractID and Eurocoinpay projects, from the second and third calls, respectively, were completed in 2023; the process was closed with the publication of the supervisor's conclusion documents on these proposals.

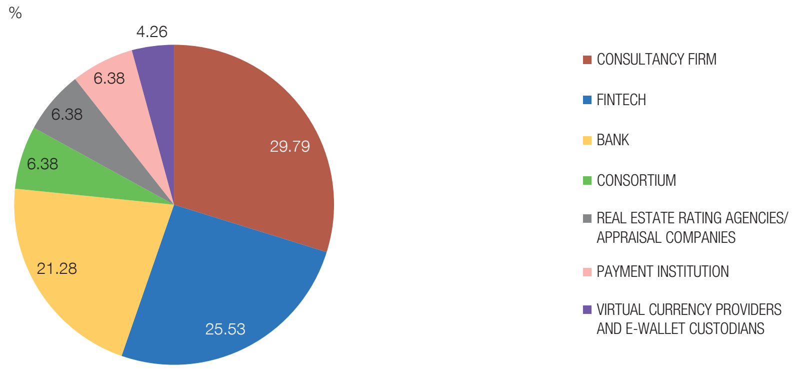
The ContractID project proposes an alternative non-face-to-face customer identification solution supported by the use of artificial intelligence and the use of strong customer authentication mechanisms provided for in the European payment services regulations. If this non-face-to-face identification mechanism were to be incorporated into the AML/CFT regulatory framework, it could be of potential benefit to users of financial services and, potentially, if it were to reduce the risk of fraud, it would also increase the efficiency of institutions or markets.

12 The Supervision Report 2021 details the characteristics of the Spanish regulatory sandbox.

13 https://www.tesoro.es/sites/default/files/20230113_resolucia3n_de_convocatoria_de_la_5aa_cohorte_del_sandbox_vf_csv.pdf

14 https://www.tesoro.es/sites/default/files/20230728%20Resoluci%C3%B3n%20de%20convocatoria%20de%20la%206%C2%AA%20cohorte%20del%20Sandbox.pdf

Chart 2.17
PROMOTERS OF THE SANDBOX PROJECTS ANALYSED BY THE BANCO THE ESPAÑA



SOURCE: Banco de España.

The Eurocoinpay project consists of a platform using blockchain technology that allows users to purchase goods and services with cryptoassets at participating merchants. This solution could potentially benefit financial service users, on the one hand, by offering an additional payment mechanism, and, on the other hand, potentially reduce costs if the method proposed by the promoter were available at lower prices than traditional payment solutions.

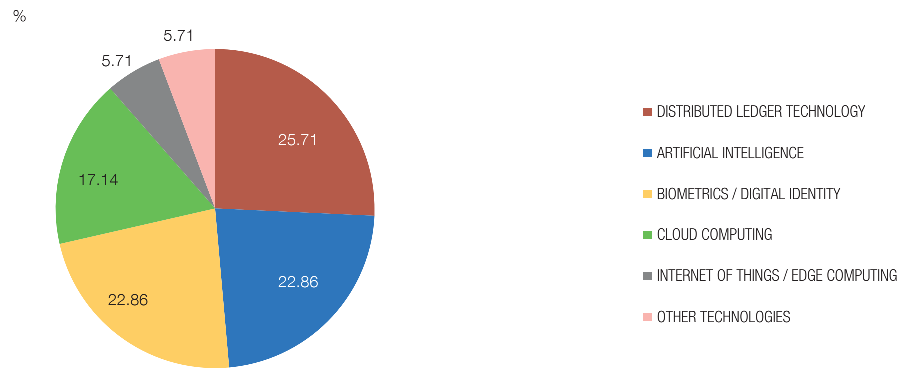
In relation to the projects from the fourth call, the Banco de España participates in the testing for Monei Eurm and Multilateral Trading System. In the latter case, the CNMV is the lead supervisor and the Banco de España acts as observer. As for the initiatives of the fifth call, this institution is monitoring the testing of various projects which are based on a digital identity solution and are called Onboarding financiero DNI Wallet, Identificación física en oficina con DNI Wallet, Segundo factor de identificación con DNI Wallet and Tarjeta Openbank en DNI Wallet.

There are various different types of promoter, including supervised and non-supervised institutions, most notably consultancy firms, FinTechs and banks (see Chart 2.17). There is also evidence of collaboration through consortia, where several promoters submit joint applications. As regards technologies, distributed ledger technology continued to dominate in 2023, followed closely by artificial intelligence and biometrics and digital identity (see Chart 2.18).

None of the projects tested in the sandbox, from its launch to date, is applicable to the better performance of the supervisory functions carried out by the Banco de España.

In 2023, the authorities responsible for the sandbox continued to work on improving its functioning. The Banco de España updated the information on innovation facilitators on its website, it made the communications channel for queries on financial innovation (provided for in Article 20 of Law 7/2020) more widely disseminated, and it continued to disseminate the sandbox and its functioning at both the national and international level. As part of this work,

Chart 2.18
TECHNOLOGY OF PROJECTS WITH FAVOURABLE PRIOR ASSESSMENT (a)



SOURCE: Banco de España.

a Projects can use more than one technology. Technologies in accordance with what is reported by the promoter in its application.

and following the event organised in Malaga on 27 January 2023[15] to learn about the experience of the promoters of the projects in the first call, the Banco de España held bilateral meetings with all the promoters who had completed their passage through the controlled testing environment. These meetings served to ascertain how this experience impacted on the promoters and to seek possible suggestions on areas for improvement.

15 Information on the event is available at https://www.bde.es/f/webeventos/Eventos/Acta_Sandbox_Malaga_2023.pdf.

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Box 2.1

THE SINGLE SUPERVISORY MECHANISM IS TEN YEARS OLD

The tenth anniversary of the Single Supervisory Mechanism (SSM) is on 4 November 2024, so it is a good time to take stock of what has been achieved so far and reflect on what lies ahead.

The creation of the SSM was a major challenge, not least because of the need to implement the new supervisory scheme in just one year, which required major transformations at the European Central Bank (ECB) and the National Competent Authorities (NCAs), and because of the difficult context in which it had to be tackled, following the major financial crisis that erupted in 2008. It has been a period of intense work and continuous improvement, which has enabled the SSM to become a robust, credible banking supervisor, able to adapt to a rapidly changing environment, and respected in the international financial community.

In this period, the Supervisory Board has played a key role, setting standards and defining priority areas for the entire organisation.

Some of the main achievements during this phase have been:

— Progress has been made in the consistent application of supervisory regulations and policies, through common guidelines and criteria on the implementation of national options and discretions.

— Supervisory practices and working methodologies have been harmonised, with the development of a supervisory manual and progress made in building a common supervisory culture.

— Risk-based supervision has been fostered, supported by a process of identifying and assessing key risks and setting supervisory priorities.

— In-depth knowledge of the supervised institutions has been achieved, through the ongoing supervision of the joint supervisory teams, specific on-sites and various cross-institutional activities.

To mark the tenth anniversary, a series of commemorative events will be organised throughout 2024, at both the ECB and the NCAs, and posters illustrating the main features of the ECB's and NCAs' supervisory systems will be displayed at the premises of each member state.

In this context, the Banco de España is organising various events:

— Public event commemorating the tenth anniversary, as part of the SSM Chair's annual visit to Spain.

— Internal seminar to discuss with staff from across the SSM what the integration of the various supervisory cultures has been like over the last ten years, the difficulties that have faced and the lessons learned from these difficulties.

— Exchange of a group of employees with other SSM institutions, with the aim of sharing experiences and fostering joint work.

— High-level discussion on the main challenges facing SSM supervision going forward.

As shown by the features of the activities planned, this anniversary is a good opportunity to give further impetus to the continuous improvement of the SSM and thus be in a position to adequately address future challenges. Some work is underway:

An expert group report on the SREP process published in April 2023 has defined a comprehensive set of recommendations, including strengthening the supervisory culture and its processes and methodologies; improving the procedures for defining quantitative requirements; and making more ambitious use of qualitative measures and the supervisor's toolkit. The concrete implementation of these recommendations will progress over the course of 2024. Also, the experience of the banking crises of early 2023 highlighted some weaknesses in supervisory frameworks (see Box 2.2) and the recent increase in geopolitical instability makes it advisable to analyse in depth how to capture the impact of certain developments on banking risks. Lastly, the debate on future supervision should take into account the impact of technological developments on risks and the competitive environment in which banks operate.

In any case, the changes to be implemented must make our supervisory process more integrated and risk-sensitive, and should pursue the following objectives:

— Increase effectiveness: developing supervision that is more sensitive to risk and geared towards attaining

Box 2.1
THE SINGLE SUPERVISORY MECHANISM IS TEN YEARS OLD (cont'd)

results that ensure compliance with an increasingly complex regulatory and operational framework. This is particularly relevant in relation to certain risks, such as governance risks, where progress has been slower.

— Improve consistency: progressing in the integration of the various components of the organisation and the harmonisation of supervisory activities.

— Increase efficiency: harnessing new technologies (most notably SupTech) to streamline and improve procedures and methodology, and generating additional space for higher value-added activities based on supervisory expert judgement.

In an economic, technological and geopolitical environment that is very different from that of ten years ago, future supervision must also be equipped with the necessary flexibility to respond swiftly to the increasingly dynamic environment. This will allow for effective action-oriented supervisory measures to be taken with a tangible impact on banking activity. The supervisor's transparency and communication with supervised entities, other related authorities and the general public should also be further strengthened.

Ten years go a long way and it seems clear that the SSM has so far been a successful experience. In this period, it has developed into a mature and increasingly integrated institution, which has contributed to preserving the solidity of the European banking sector in a highly uncertain environment. But there is still room for improvement and the new challenges of the future will need to be tackled ambitiously in a changing economic and technological context.

Box 2.2

RECENT BANKING CRISES: CAUSES AND SOME LESSONS FOR SUPERVISION[1]

Between March and May 2023, there was the chain crisis of several US regional banks (Silicon Valley, Signature and First Republic) and of the Swiss bank Credit Suisse which, due to its size and complexity, was classified as a global systemically important bank according to BIS international standards.

The interest rate rises against a backdrop of inflationary pressures and the uncertainty about macro-financial conditions that stems from existing geopolitical risks were the main trigger for this crisis, which affected institutions with weaknesses that made them especially vulnerable in this context.

The crisis started in Silicon Valley Bank (hereafter SVB). This institution showed a significant concentration of liabilities in deposits with high average balances, not covered by the deposit guarantee fund and concentrated in the technology and venture capital sectors; on the asset side, long-term debt portfolios classified as held-to-maturity, and acquired before the rise in interest rates, had a significant weight. The tightening of monetary policy led to significant decreases in the valuation of these debt portfolios, which SVB was forced to materialise in order to try to alleviate the liquidity pressures arising from the deposit outflows it had been experiencing. Negative news further accelerated this process, favoured by the concentration of depositors and the rapid spread of these concerns on social media.

Following this event, markets focused on institutions showing weaknesses of some kind, leading to significant deposit outflows and liquidity problems that fed off each other, in cases such as Signature Bank and First Republic. The Swiss bank Credit Suisse was affected by the mistrust generated in the markets by the US bank crises, as it had been showing weaknesses in its governance and risk management, which affected its liquidity and posed a significant threat to its viability.

The affected institutions found themselves needing to turn to the markets to maintain their liquidity levels, which further stimulated scrutiny and doubts about their situation, and revealed significant shortcomings in their interest rate and liquidity risk management which, far from being the result of a temporary situation, had been developing over time.

Deposit withdrawals and contagion effects affected institutions that shared, to varying degrees and with some different characteristics, certain underlying factors: i) lack of sustainability of their business models and of a comprehensive business perspective, with their activity strongly linked to certain sectors (e.g., SVB with the technology and venture capital sector; Signature with the crypto sector); ii) poor management of liquidity in relation to their liability structure, and inadequate management of collateral available for use in markets or with the central bank; iii) inappropriate interest rate risk management, with a high concentration of liabilities in deposits susceptible to high volatility and a concentration of assets in long-term debt portfolios classified as held-to-maturity; and iv) inadequate governance, with weak risk control and monitoring by the institutions' management bodies.

Liquidity pressures prompted swift reactions by the authorities, which provided additional liquidity lines to those already in place and took certain extraordinary measures aimed at curbing contagion effects. However, these actions could not stop the major, rapid outflows of funds from the affected institutions and, therefore, the supervisory and resolution authorities had to intervene to safeguard the stability of the banking system.

Subsequent reports prepared by US and Swiss supervisors and by some international bodies revealed that certain vulnerabilities had not been detected and, where identified, they had not always been addressed effectively.[2] These analyses suggest some important areas of improvement in supervision, including most notably: a) the need to ensure that the structure and focus of supervision provide a holistic picture of institutions' risks, with greater emphasis on the sustainability of the business model and on liquidity and interest rate risks; b) the need to improve the supervisory decision-making process, streamlining its management and establishing clear processes for the escalation of supervisory measures; and c) the need for

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1 For further analysis of these crises and the lessons learned, see the Financial Stability Review Autumn 2023 article The 2023 banking crises: The causes and the role played by bank management, supervisors and regulators.

2 See Basel Committee on Banking Supervision. Report on the 2023 banking turmoil.

Box 2.2
RECENT BANKING CRISES: CAUSES AND SOME LESSONS FOR SUPERVISION[1] (cont'd)

swift corrective measures to address identified shortcomings (enforcement).

These areas for improvement are a point of reflection for all supervisors, although they are not equally applicable in all jurisdictions. There are significant differences between the supervisory structure and approach in the United States, Switzerland and the European Single Supervisory Mechanism (SSM). Thus, for example, in the US, unlike in Europe, the Basel standards do not apply in full to smaller institutions, such as those affected by the crisis. In the case of Credit Suisse, as a globally systemically important institution, its supervision has faced greater complexities than those existing at medium-sized institutions.

In short, the crises mentioned above show the significance of confidence and the contagion effects in the development of crises, especially in environments such as the current one, where the speed of communication and the dissemination of information is high. Also, as is becoming the norm in all crises, the institutions that show the most weaknesses and shortcomings in internal control and risk management are the most sensitive to these contagion effects and the consequent withdrawal of funds. These institutions are the most prone to liquidity pressures that feed off each other and can eventually render an institution unviable.[3] This crisis also offers valuable lessons for the supervisory approach. In particular, it has highlighted the importance of a holistic analysis of business models and of attention to asset and liability management, and it has revealed the need to act swiftly to remedy detected shortcomings, with the focus on the effectiveness of supervisory measures (see Box 2.3).

3 See, on this subject, A. Enria. (2023). *Well-run banks don´t fail-why governance is an enduring theme in banking crises;* Federal Reserve Board. (2023). *Review of the Federal Reserve Supervision and regulation of Silicon Valley Bank,* and Federal Deposit Insurance. (2023). *Remarks on Oversight of Financial Regulators: Financial Stability, Supervision, and Consumer Protection in the Wake of Recent Bank Failures.*

Box 2.3

CONSIDERATIONS ON THE EFFECTIVENESS OF SUPERVISORY ACTION

The crisis experienced in the first half of 2023 by certain US and Swiss banks has been the subject of analysis by the main international supervisors and bodies. In its report on the factors that contributed to the collapse of Silicon Valley Bank, the Federal Reserve noted that supervisors failed to adequately identify vulnerabilities as the bank grew in size and complexity. Also, when these vulnerabilities were identified, the necessary actions to correct them were not taken quickly enough.

As a result of this experience, the effectiveness of supervision has been at the centre of debate in the supervisory community, as evidenced by the analyses of the lessons learned from this episode carried out by various bodies (e.g. the International Monetary Fund (IMF) or the Basel Committee on Banking Supervision (BCBS)) and the work initiated by certain supervisors, including the Single Supervisory Mechanism.

The first precondition for effective supervision is a sound supervisory framework. In this regard, there is a broad consensus on a series of minimum standards, which are set out in the BCBS's "Core Principles for effective banking supervision" (updated in 2023). These standards cover a very wide range of issues, such as the institutional supervision framework, the treatment of key risks, the supervisory approach and the powers granted to supervisory authorities.

Effective supervision should ensure that institutions have adequate capital and liquidity buffers and that indicators of key risks are kept at manageable levels. In this respect, the evolution of the banking sector in Spain and in Europe has on the whole been very favourable in recent years: average capital ratios show a clear upward trend over the years; a notable effort has been made to reduce the portfolio of non-performing assets, as reflected in the significant decline in NPL ratios and foreclosed assets; profitability, another focus of supervisory attention in recent years, has improved, favoured by the normalisation of monetary policy; and liquidity ratios are also at comfortable levels.

In addition, European institutions have passed various stress tests and vulnerability analyses, which show high resilience under hypothetical stress scenarios, and have successfully withstood certain significant shocks in recent years, such as the COVID-19 crisis, the implications of the war in Ukraine and other geopolitical tensions, as well as the instability associated with the banking crises in the first part of 2023.

Supervisory activity within the SSM framework has contributed to this positive performance, tending towards higher standards and seeking a greater impact on institutions, and focusing on the most relevant risks and shortcomings. In recent years, special emphasis has been placed on areas such as credit risk management, the functioning of institutions'

Chart 1
IDENTIFICATION OF SHORTCOMINGS WITH HIGH SEVERITY. SPANISH SIGNIFICANT INSTITUTIONS (a)

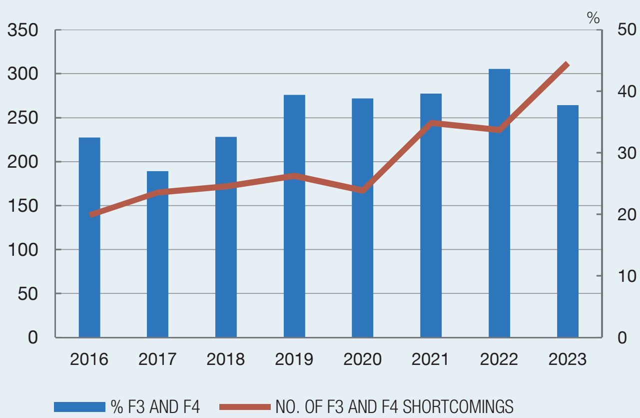
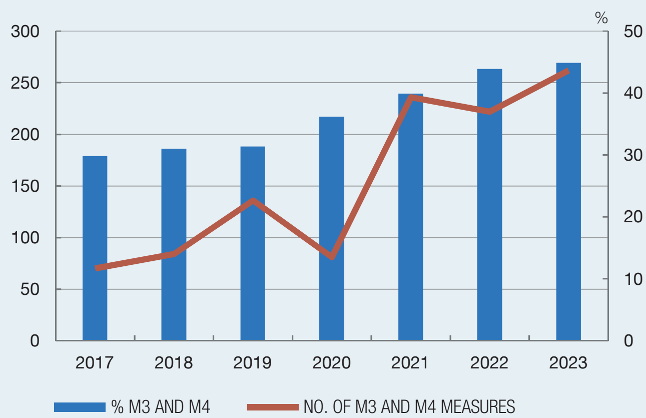


Chart 2
CLOSURE OF MEASURES WITH HIGH SEVERITY. SPANISH SIGNIFICANT INSTITUTIONS (b)



SOURCE: Banco de España.

a The Chart represents the number of shortcomings with high severity (F3 and F4) identified each year (left-hand scale) and their relative weight with respect to the total shortcomings with severity assigned (right-hand scale) of Spanish significant institutions.

b The Chart represents the number of measures with high severity (M3 and M4) closed each year as they are considered to be reasonably remedied (left-hand scale) and their relative weight with respect to the total measures with severity assigned closed in the year (right-hand scale) of Spanish significant institutions.

Box 2.3
CONSIDERATIONS ON THE EFFECTIVENESS OF SUPERVISORY ACTION (cont'd)

management bodies, the sustainability of business models and the operational resilience. More recently, liquidity and funding risks, interest rate risk and climate risk have become increasingly significant.

After ten years of the SSM functioning, the supervisor's knowledge of the system as a whole has progressively increased and ever more mature tools and methodologies have been developed to assess the main risks. This greater level of scrutiny has led to an increase in the number and significance of shortcomings identified in supervisory work, despite institutions' progress.

In the case of Spanish significant institutions under the direct supervision of the ECB, there is an upward trend in the identification of shortcomings with high severity (levels 3 and 4), which also account for a higher relative weight of the total shortcomings detected in recent years (Chart 1). Similarly, growing supervisory pressure on institutions to give priority to remedying their most significant shortcomings has been reflected in the greater remediation of shortcomings (corrective measures) with high severity in recent years as compared to previous years, in both absolute and relative terms (Chart 2).

In the case of the Spanish less significant institutions under the direct supervision of the Banco de España, the identification of shortcomings from inspections increased in the period from 2018 to 2023 (Chart 3), while the proportion of weaknesses with high severity (levels 3 and 4) with respect to the total has remained stable, with the exception of 2022, when it was significantly higher (Chart 4).

However, despite the overall improvement in institutions' resilience, the degree of progress across the SSM as a whole has not been the same for all risks. For example, in areas such as governance or risk data aggregation capacity, some problems are persistently being detected, the correction of which is slower than is desirable, partly because the shortcomings in these areas, especially in the case of governance, are of a qualitative nature and tend to take longer to remedy.

The effectiveness of supervisory action is linked to the selection of an appropriate combination of supervisory measures. In this regard, the report on the SREP, entrusted by the SSM to a group of independent experts, stresses that capital is not sufficient to address all risks, and recommends that the ECB make extensive use of the tools at the supervisor's disposal, including a more ambitious use of qualitative measures, aimed at getting banks to address necessary improvements in their business models and governance.

In this vein, the SSM has focused on improving supervisory effectiveness, especially in those areas where the weaknesses detected are most persistent. To this end, the supervisor must make an effort to prioritise and communicate its concerns to institutions as clearly and precisely as possible. In addition, work is being done on the design of escalation processes, using progressively more intrusive supervisory

Chart 3
LSIs

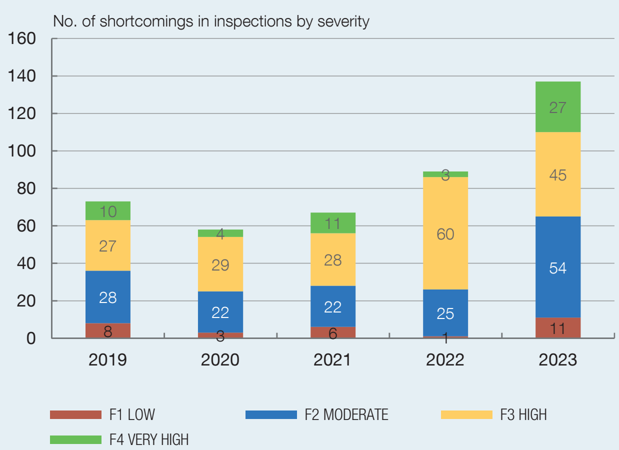
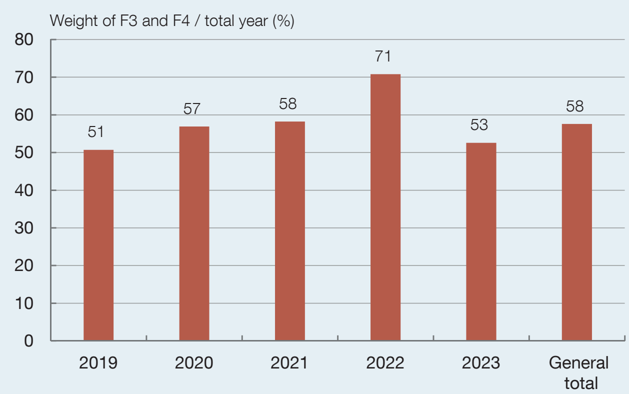


Chart 4
LSIs



SOURCE: Banco de España.

Box 2.3
CONSIDERATIONS ON THE EFFECTIVENESS OF SUPERVISORY ACTION (cont'd)

measures to incentivise corrective actions by institutions. This includes more intensive use of the qualitative requirements in the SREP and, where necessary, of the framework for sanctions and periodic penalty payments provided for in the SSM Regulation.

The increased focus on supervisory effectiveness also applies to less significant institutions. In the supervision of these institutions, which are smaller and have less complex business models, the focus is being placed on prioritising the most significant risk areas and on increasing supervisory pressure, including thematic actions on the highest priority issues and the adoption of binding measures within the SREP framework, in order to bolster institutions' resilience.

Box 2.4

CLIMATE RISK AND SUSTAINABLE ECONOMY

The European Central Bank (ECB), in close cooperation with the national competent authorities and on the basis of a comprehensive assessment of the main risks and vulnerabilities of the supervised institutions, performs annual reviews of the SSM supervisory priorities, which reflect its strategy for the next three years.

In December 2023, the supervisory priorities for 2024-2026 were published;[1] as in recent years, they highlight the need for credit institutions to continue working to resolve weaknesses related to the incorporation of climate and environmental risks into their risk management framework. This demonstrates European banking supervisors' commitment to play a major role in the fight against climate change and the transition to a more sustainable economy.

Given the priority nature of climate and environmental risks, numerous supervisory activities were developed in 2023, that will continue over the coming years, including most notably, in the case of significant institutions, the following:

— Specific monitoring of the weaknesses detected in the 2022 thematic review, which resulted in qualitative requirements being imposed on institutions with severe shortcomings in their materiality and business context assessment.

— On-site inspections on climate and environmental risks.

— Analysis of climate risk information that significant institutions published for the first time under Pillar 3 standards in the first half of 2023.

— Preparation and launch of the Fit-for-55 exercise, scenario analysis which aims to assess how public policies for the transition to a more decarbonised economy would affect the financial system (banking, securities and insurance).

For the less significant institutions, directly supervised by the Banco de España, an analysis of their progress in implementing the supervisory expectations on climate and environmental risk management that were published by the Banco de España in October 2020 was carried out by means of two questionnaires sent to all institutions. In parallel, there has been a progressive inclusion of the considerations on these risks in the supervisory dialogue and recommendations issued under the SREP.

As regards these institutions, the Banco de España will intensify the specific monitoring of these recommendations through horizontal on-site reviews across a sample of institutions to verify, among other aspects, whether institutions integrate the risks arising from climate change and environmental degradation into their current risk management procedures, and whether they have implemented a comprehensive approach to the identification, assessment, monitoring and mitigation of these risks.

The importance of these supervisory activities is given by the weight of the most carbon-intensive sectors in the credit exposure and income of European banks, and by recent developments in climate and environmental risks, including most notably the following:

— on a global scale, greenhouse gas emissions continue to rise, causing global warming which leads to an increase in physical risks;

— transition risks are increasing, due to the delay in the adoption of policies and measures to meet climate objectives, together with the need to invest in low-emission technologies that, in many cases, are costly or not sufficiently developed; and

— society's level of awareness is growing and, therefore, there is greater demand for sustainable goods and services, and greater scrutiny of companies' and institutions' behaviour, which increases their operational and reputational risks.

For the proper integration of these risks into their practices, institutions face well-known challenges. These include, among other things, the limited availability of quality data to assess climate risks, the very nature of the risks and the high uncertainty as to their materialisation, which require a long-term approach, exceeding the usual periods used by institutions in their customary planning. Also, although progress is being made, the methodologies for estimating these risks still lack the necessary sophistication for proper assessment.

1 See “ECB Banking Supervision: supervisory priorities for 2024-2026”.

Box 2.4
CLIMATE RISK AND SUSTAINABLE ECONOMY (cont'd)

In this context, supervisors are playing a very active role, maintaining constant dialogue with institutions, publishing observed good practices and contributing to regulatory developments in this area.

It is important to note the significance of the transition plans that credit institutions will have to draw up. The fact that they will necessarily have to rely on the plans produced by their main counterparties will pose an additional challenge to those already mentioned. It is essential that credit institutions maintain fluid communication with their customers to learn about their transition plans and the technological developments and investments needed to implement them. Channelling capital only to industries that can already be described as "sustainable" would make it practically unfeasible to achieve the European Union's climate targets. The ECB, in turn, will develop an approach for analysing these plans as part of its supervisory review and assessment process.

Box 2.5
THE NEW DIGITAL OPERATIONAL RESILIENCE ACT

As part of its digital finance strategy, and in order to mitigate the risks associated with digitisation and improve the resilience of the European financial system, the European Commission published in September 2020 its legislative proposal for a new digital operational resilience act, known as DORA.

After a two-year negotiation process, the final text of DORA was published in December 2023, and its date of application is January 2025.

The fact that the chosen legislative instrument is a regulation ensures that the same standard will apply in all EU countries, thus achieving an unprecedented harmonisation of ICT resilience regulation for the European financial system.

The scope of DORA is surprisingly broad, as it will apply to all types of financial institutions, of all sizes, with due proportionality. The Commission thus recognises that, given the high level of interconnections and interdependencies between the various institutions that make up the financial system, it is essential to ensure minimum levels of resilience common to all of them in order to make the whole sector resilient.

Resilience is by no means a mere compliance exercise. In a true statement of principles, the chapter on technology risk management begins with an article on governance and organisation, setting out the responsibilities and obligations of institutions' management bodies, which will need to understand these risks and be directly involved in their management. For many institutions, this will be a turning point that will force a review of the composition of their management bodies, their functions and their level of involvement in the institutions' operational resilience.

While it could be argued that DORA's requirements on technology risk management, technology incident management and reporting, system resilience testing and third-party risk management are not entirely new, it is a novelty to have elevated them to the status of a sector-wide regulation. At present, financial institutions' resilience levels are not homogeneous and, therefore, the effort they will have to make in order to comply with the DORA requirements will also differ from case to case. This is of particular concern to smaller institutions, for which it can be a major challenge to equip themselves with the necessary technical and human resources.

One of the new developments with the greatest impact on supervisors is the DORA provisions on advanced cybersecurity testing (Threat-Led Penetration Tests), similar to those already in place in some countries, including Spain, under the TIBER framework. These tests will have to be carried out with a certain frequency (in principle every three years) and will be required for a potentially large number of institutions, which will require significant supervisory resources. While some institutions already undertake these tests on a voluntary basis, for others it will imply raising standards substantially.

Also, DORA contains provisions encouraging institutions to voluntarily share threat and vulnerability intelligence, as, while the benefits of such sharing are undisputed, there is often reluctance to do so.

But, undoubtedly, the most talked-about feature of DORA, which has made the regulation a global benchmark, is the establishment of a new oversight framework for the external technology providers that are critical to the European financial system as a whole, an aspect that is becoming increasingly significant given the growing trend towards the outsourcing of certain critical functions. The Commission is aware that in order to improve the level of resilience of the sector, it is essential to take into account the technology service providers supporting institutions' critical business functions, especially those ones that have reached a systemic dimension. The new oversight scheme will be led by European supervisory agencies, although national supervisors will have to support this function.

The implementation of this oversight mechanism is requiring and will require a significant effort on the part of all the authorities in the European financial sector, including the Banco de España. Initially, procedures and methodologies will have to be developed in order to carry out effective supervision of large, complex companies with widely differing business models, organisation and governance structures, with which the financial supervisors are not familiar. Also, the authorities will have to equip themselves with the necessary additional resources, which will involve bringing in a significant number of professionals with a high level of technical expertise. This type of profile is rare and highly solicited by all types of companies, so recruiting and retaining them will be a challenge for supervisors.

Beyond the above-mentioned aspects, it is also worth noting that the regulation establishes numerous additional

Box 2.5
THE NEW DIGITAL OPERATIONAL RESILIENCE ACT (cont'd)

obligations for the competent authorities, thereby recognising that they are key players in the ecosystem. We will need to make an unprecedented coordination effort, and play an active role beyond our responsibility as overseers of regulatory compliance, for example by promoting sectoral resilience exercises.

Box 2.6

BANKING APPLICATION OF MACHINE LEARNING TECHNIQUES IN INTERNAL RATINGS-BASED MODELS. SUPERVISORY APPROACH

The last five years have seen a growing use of artificial intelligence techniques —and, in particular, machine learning (ML) — for credit risk measurement and management. The implementation of this type of methodology is still a minority in industry, but its possibilities have aroused great interest and there is a continuous upward trend in its use. In addition to enabling the exploitation of new data sources, one of the major benefits of these models is their capacity to provide more accurate risk estimates.

In certain cases, financial institutions are incorporating ML techniques into credit risk models, where they play a central role, mainly scoring or rating counterparties based on their risk. Since 2018, there have been examples in the Single Supervisory Mechanism (SSM) of the use of these advanced techniques in models that have been approved. As well as in credit risk, ML is also being used in other financial risks, such as market and counterparty risk, or in the context of Pillar 2.

On the supervisory side, there is a degree of caution as to the use of ML in internal ratings-based (IRB) models for the calculation of capital requirements, mainly due to the difficulty in interpreting and explaining such techniques, which are sometimes referred to as "black boxes" precisely because their greater complexity limits the ability to understand how the results are arrived at. In this regard, it should be noted that understanding the internal behaviour of a model and how it generates forecasts is necessary to ensure its alignment with economic logic and to allow, where appropriate, manual adjustments to the ratings (overrides).

At present, supervisory and regulatory bodies are working intensively in this field, promoting communication with stakeholders to ascertain the degree of maturity of these approaches, to find out which types of developments the institutions are planning to undertake and to clarify regulatory expectations.

There is also significant interest among Spanish institutions in the use of ML techniques, and several initiatives have been developed for their use as a central part of IRB models, the approval of which has involved the dedication of supervisory resources. It is worth noting that, in several of the models presented, the difficulty in interpreting the model's internal logic has been addressed by introducing constraints into the models. In any case, while the introduction of such constraints provides valuable insight into the functioning of the model, it does not by itself completely resolve the "black box" problem.

The application of ML techniques in the area of credit risk is not confined to capital estimation models; it is also generating interest in loan origination areas, where the greater predictive capacity as compared to traditional techniques would have a direct economic impact on institutions. Such uses will have a specific regulatory framework under the AI Act, but they are also subject to the requirements set out in the general data protection regulation. Among other issues, this regulation addresses personal data exploitation and the prevention of discriminatory bias, which can be a challenge when using such techniques.

The emergence of ML in credit models is an interesting challenge. Through its supervisory function, the Banco de España will be able to examine firsthand how these techniques penetrate the banking environment, and will monitor their repercussions on management tasks and on access to credit. Moreover, it will require the update of professional profiles and an even greater involvement in training and research to understand both the capabilities and limitations of this disruptive technology.

1 ML is a field of artificial intelligence that generates knowledge from big data processing.

2 As well as being useful in terms of management, this scoring or rating serves as a first step in many internal ratings-based (IRB) models to define sets of counterparties with a similar level of risk and, subsequently, quantify their risk. In addition to these scoring processes, there are also other uses with a more secondary role, for example, the initial processing of the data.

3 A survey is currently being conducted by the ECB, in addition to the survey in the European Banking Authority's Discussion paper on machine learning for IRB models.

4 In this way, certain patterns in the variables are imposed in advance, which favours alignment with economic or business logic. For example, the relationship between the borrower's income and the probability of default is always forced to be negative.

5 Regulation of artificial intelligence, which specifies various requirements for the use of ML techniques in the granting of credit, as it is considered an essential service for individuals.

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Box 2.7

SUPTECH DEVELOPMENTS (TECHNOLOGICAL INNOVATION APPLIED TO SUPERVISION)

The Banco de España included the need to boost technological innovation in its 2024 Strategic Plan. To this end, among other initiatives, in the supervisory sphere it designed a roadmap for incorporating new technologies into supervisory activity.

One of the pillars on which this roadmap is based is the internal development of SupTech tools. To undertake this task, it is essential to combine people with training in new technologies and knowledge of and experience in the banking supervision function, and access to rich and quality data sources.

Three data sources can be accessed for the development of SupTech tools: i) information from confidential returns; (ii) granular loan information, mainly from the Banco de España's Central Credit Register (CIRBE); and (iii) unstructured data in the form of text: internal capital and liquidity adequacy assessment reports, news, contracts, etc.

The combination of both factors —appropriately trained and experienced staff and quality data sources— should take us to the highest level of the well-known "Data, Information, Knowledge, Wisdom" pyramid (Figure 1), and thus have the capacity to make well-informed decisions based on an understanding of the underlying information, in order to improve the effectiveness and efficiency of supervision.

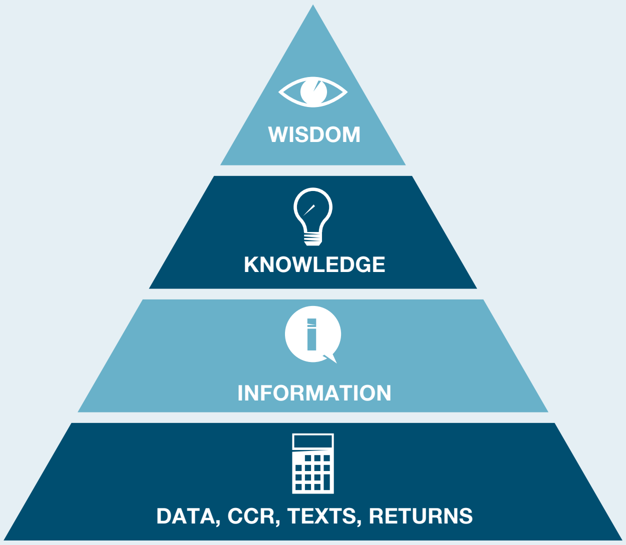
In the development of SupTech tools, four lines of work can be distinguished, which, based on the available data sources, interact in some way with each other (Figure 2):

1 **Improving the quality of the information reported in the CIRBE.** One of the techniques used to identify shortcomings in data quality is the reconciliation of the data reported to the CIRBE with the corresponding information in the confidential returns reported.

2 **Detecting changes in trends and anomalous data based on machine learning algorithms.** An example of this line of work is the tool called Avalanch, which analyses on a monthly basis, by using machine learning models, possible significant changes in the information received on new mortgage loans. The tool applies the adversarial validation technique, which is widely used in artificial intelligence to identify possible differences between two datasets.

Using an algorithm with a hierarchical decision tree structure (Figure 3), the most predictive variables are recursively searched and datasets are compared on a monthly basis, looking for significant changes or outliers. For example, between loans of a certain type granted by one institution on different dates; between loans granted by one institution versus another; or

Figure 1
DATA SCIENCE AS A PYRAMID, WITH DATA AT ITS BASE



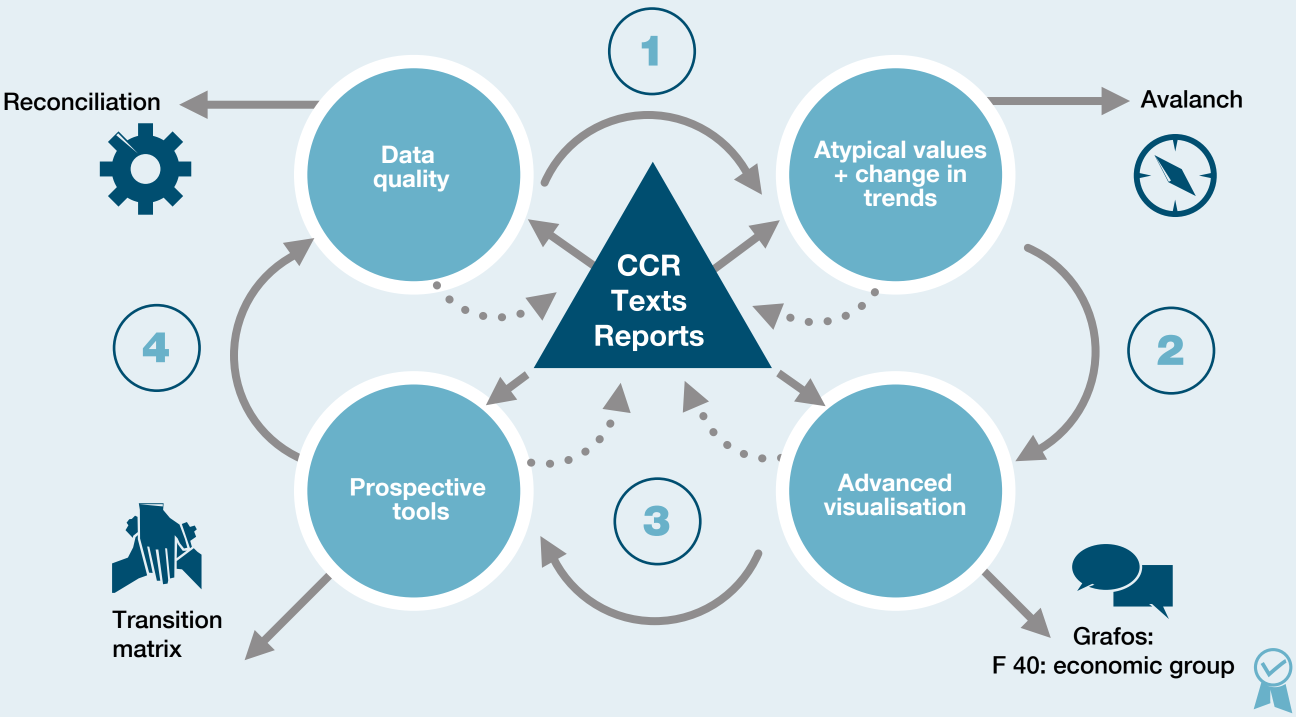
SOURCE: Banco de España.

Box 2.7

SUPTECH DEVELOPMENTS (TECHNOLOGICAL INNOVATION APPLIED TO SUPERVISION) (cont'd)

Figure 2

INTERRELATION AND INTERACTION PROCESSES



SOURCE: Banco de España.

differences between sub-populations of the same institution (e.g. between transactions granted through an agent versus those granted by the institution's branches). In this way, changes in loan origination policies, anomalous data, reporting errors, etc. can be detected.

3 **Graphical representation of large amounts of data to facilitate their interpretation and analysis.** Noteworthy is the tool called Grafos —a tool that we are going to share with the SSM, in our capacity as SupTech centre— which allows the interactive visualisation of "multiple relationships (n to m)".

Certain complex relationships can be represented by graphs that facilitate analysis. For example: based on granular information on loan portfolios, relationships (n to m) between debtors, guarantors, collateral and/or economic groups of a set of loans can be represented by graphs; further, ownership relationships between companies forming an economic group can also be represented by graphs.

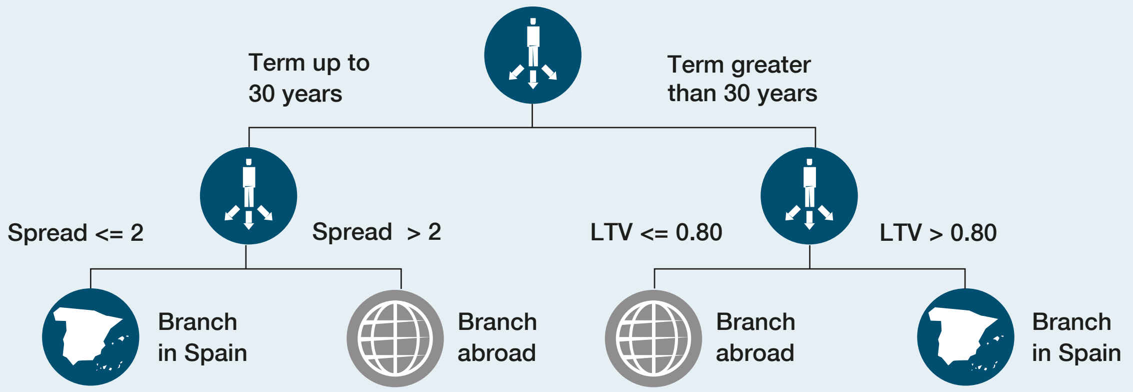
In the latter case, the visualisation of the multiple relationships of an institution's investee structure makes it possible, for example, to identify the main changes in an economic group between various dates or the structure resulting from mergers and acquisitions between credit institutions; to analyse the impact on solvency of regulatory amendments; or to analyse subsets of the economic group (e.g. the group in a given country).

The tool provides basic graphical capabilities for marking nodes and paths, interactive searches and filtering, or navigation functions through the graph. It also makes it possible to compare graphs (changes in a group between two dates), to perform graph calculations (e.g. to calculate the effective ownership interest percentages that a parent company has in its subsidiaries in complex structures), to identify ownership interests that are in loops (which may lead to capital inefficiency) or to show all paths from the parent company to each investee.

Box 2.7

SUPTECH DEVELOPMENTS (TECHNOLOGICAL INNOVATION APPLIED TO SUPERVISION) (cont'd)

Figure 3
AVALANCH. CASCADING DECISION TREE



SOURCE: Banco de España.

It is also a lightweight tool, easily integrable into Office, which does not require the installation of complicated new environments or other components on the supervisor's basic workstation.

4 **Exploration of predictive capacity based on CIRBE information and extraction of information from unstructured texts.** An example of a tool that explores predictive capacity is the so-called Transition Matrices, which tries to study the payment behaviour of loans and credits through the monthly analysis of the number of months in arrears of each operation reported to the CIRBE.

The tool compares the status of each loan in two consecutive months and generates the percentages of the money exposure that migrate between one arrears level and the other (percentage of the exposure with "x" months in arrears reported in the month that moves to "y" months in arrears in the following month), resulting in a "transition coefficient matrix" between in arrears statuses.

The statistical treatment of these monthly transition matrices makes it possible to project an estimate of future losses of the portfolios (the time evolution of which is an indicator of their quality) or to identify anomalous behaviour in the portfolios.

Box 2.8

ANTI-MONEY LAUNDERING: THE NEW REGULATORY PACKAGE AND THE ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM AUTHORITY

In July 2019, following several money laundering scandals in credit institutions operating in various European Union (EU) Member States, the European Commission published, among other documents, an analysis highlighting a number of shortcomings in the implementation of the EU legal framework on anti-money laundering and countering the financing of terrorism (AML/CFT) in areas such as the supervision and cooperation between Financial Intelligence Units (FIUs). This analysis concluded that the EU legal framework needed to be reformed to ensure its effectiveness and coherence, as the minimum harmonisation approach to AML/CFT legislation at the time resulted in different regulatory and supervisory frameworks.

In this regard, international AML/CFT regulations have traditionally been implemented in the EU via directives (there have been five directives since 1991), and a certain degree of flexibility has been permitted in their transposition into national frameworks. Reality has shown that such a transposition scheme is inadequate in the area of AML/CFT, and that a truly single EU-wide regulatory framework is needed instead.

AML/CFT supervision, in turn, has so far been entrusted to the national competent authorities, designated by Member States when transposing the successive directives; the various NCAs have different mandates and characteristics. Recent scandals have shown that, in certain cases, these authorities lacked the resources required to prevent them from occurring.

On 7 May 2020, the European Commission presented an action plan for a comprehensive EU-wide AML/CFT policy, defining six priorities or pillars:

1 Ensuring the effective implementation of the existing AML/CFT framework.

2 Establishing a single rulebook on AML/CFT.

3 Bringing about an EU level AML/CFT supervision.

4 Establishing a support and cooperation mechanism for FIUs.

5 Enforcing Union-level criminal law provisions and information exchange.

6 Strengthening the international dimension of the EU AML/CFT framework.

The EU is addressing these priorities by creating, through a Regulation, the new Anti-Money Laundering and Countering the Financing of Terrorism Authority (hereafter AMLA), and strengthening legislation with two legislative proposals (a new directive and a regulation that is directly applicable across the EU, which are expected to be finalised by June 2024).

The new regulation responds to the aforementioned need to harmonise key aspects of the regulations applicable to the private sector, such as the definition of obliged entities, the cases in which enhanced diligence measures apply, the limits on the use of cash, the rules on beneficial ownership and the application of enhanced measures to transactions with high-risk third countries. The AMLA Regulation was agreed by the Council and the EU Parliament in December 2023, while political agreement on the Directive and Regulation was reached in January 2024. In a significant development, on 22 February 2024, the Council and Parliament agreed that the seat of the new prevention authority will be in Frankfurt. Following this key decision, the AMLA will be legally constituted in September 2024, but will not be fully operational until mid-2025.

The current set-up of AML/CFT supervision has given rise to uneven quality and effectiveness across the EU. It is clear that shortcomings in the supervision of a national competent authority on AML/CFT can create material risks for the single market as a whole. It is worth recalling that recent money laundering scandals in the EU had a cross-border dimension and, therefore, it is necessary that AMLA and the national AML/CFT supervisory authorities form an integrated AML/CFT supervisory system, of which the new authority will be the central element.

The articulation and coordination of AML/CFT supervision by AMLA will undoubtedly be a major challenge, and one for which Spain in general — and the Banco de España in particular— is prepared. In this respect, the soundness of the Spanish regulatory and institutional framework, which has the highest compliance ratings according to the Financial Action Task Force (FATF), is an excellent starting point. The Banco de España, as an integral part of our institutional framework for AML/CFT supervision together with SEPBLAC, will actively contribute to this process, also building on the experience gained and lessons learned following the creation of the Single Supervisory Mechanism (SSM) a decade ago. Also, credit institutions will have to adapt and respond to the challenges posed by the new

Box 2.8

ANTI-MONEY LAUNDERING: THE NEW REGULATORY PACKAGE AND THE ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM AUTHORITY (cont'd)

regulatory framework and, in particular, by the new AML/CFT supervisory scheme of which the AMLA will be an essential part. However, the experience accumulated by institutions in the SSM's ten years of existence, as well as the demanding Spanish regulatory framework, are strengths for this transition to the European regulatory and supervisory framework.

Like the SSM, AMLA will be responsible for the direct supervision of a limited number of higher-risk obliged entities in the financial system with cross-border activity. Also, it will coordinate and supervise AML/CFT supervisors in the financial and non-financial sectors. It will also coordinate and support FIUs in their joint analysis of transactions reporting and suspicious activity with a cross-border dimension. In addition, it will be responsible for monitoring, analysing and exchanging information on money laundering and terrorist financing risks affecting the internal market.

3

MACROPRUDENTIAL POLICY

EVOLUTION OF SYSTEMIC VULNERABILITIES

The regular monitoring of systemic vulnerabilities through indicators and stress tests did not trigger any risk alerts

MACROPRUDENTIAL TOOLS

Two types of capital buffers are regularly set: CCyB and buffers for global and other systemically important institutions (G-SIIs/O-SIIs). The adequacy of sectoral concentration and loan origination conditions is also assessed

COUNTERCYCLICAL CAPITAL BUFFER (CCyB)

The CCyB rate was maintained at 0%, as this was considered the appropriate level given the absence of cyclical imbalances, the geopolitical uncertainty, high inflation and tightening of the ECB's monetary policy

SYSTEMICALLY IMPORTANT INSTITUTIONS

One G-SII and four O-SIIs were identified

AMCESFI

The macroprudential inter-agency body (AMCESFI), in which the Banco de España participates, has now been in operation for five years

COORDINATION IN THE SSM

Collaboration with the ECB and the SSM national authorities on: i) analysis of risks to financial stability, and ii) exchange of information on national macroprudential measures

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3.1 Macroprudential tools

The activation of macroprudential tools seeks to mitigate risks and systemic vulnerabilities, improving banks' shock absorption capacity and limiting the effects of shocks on the provision of funding and on the real economy. In 2023, the Banco de España reviewed the adequacy of the levels of the macroprudential capital buffers which address the build-up of cyclical and structural risks, respectively: (i) the countercyclical capital buffer (CCyB); and (ii) the buffers for Spanish global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs). Moreover, it was not deemed necessary to activate any of the other macroprudential tools available in the legislation, due to the absence of signs of imbalance that justify it. These decisions are based on various methodologies, ranging from a broad set of indicators on the macro-financial environment to stress tests on Spanish banks, together with other more specific methodologies.[1]

3.1.1 Stress tests

For macroprudential purposes, the Banco de España performs annual assessments of credit institutions' resilience under central macroeconomic forecasts and under the potential materialisation of adverse scenarios. Specifically, the solvency analysis focuses on estimating the level of the CET1 capital ratio in these scenarios over a three-year time horizon. The 2023 tests, as in previous years, used a methodological framework developed in-house by the Banco de España, known as the Forward-Looking Exercise on Spanish Banks (FLESB). It uses assumptions and models consistently across all of the banks analysed (top-down approach). FLESB uses highly granular information available from regulatory and supervisory reporting to project the evolution of institutions' balance sheets and income statements.[2]

1 For more details on risk identification indicators, see C. Broto (coord.) et al. (2021). "Banco de España Strategic Plan 2024: Risk identification for the financial and macroeconomic stability - How do central banks identify risks? A survey of indicators". Occasional Papers, 2125, Banco de España.

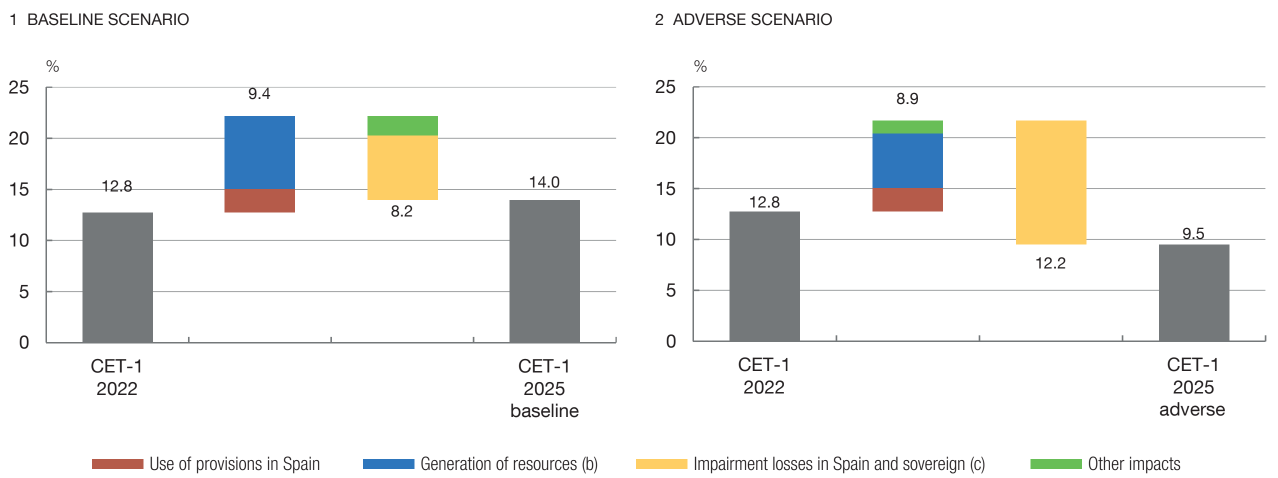
2 Each autumn issue of the Banco de España's Financial Stability Report presents the results and the main methodological improvements included in each exercise. The basic structure of this stress test framework can be seen in the 11/2013 Financial Stability Report of the Banco de España.

This exercise used macroeconomic scenarios from 2023 to 2025 in line with those used in the European Banking Authority (EBA) 2023 stress tests.[3] In particular, the baseline scenario reflects the expectations of the evolution of the economic environment at the closing date of the scenarios for the EBA test.[4] The adverse scenario, in turn, incorporates the possible materialisation of various risks, in particular those related to the possibility of geopolitical tensions intensifying. This scenario is especially severe as it assumes a hypothetical stagflationary environment, with further increases in energy and food prices, higher interest rates and disruptions in global value chains. It is worth noting that for the first time the scenarios

Chart 3.1

MACROPRUDENTIAL FLESB STRESS TESTS. IMPACT ON THE CET1 RATIO (a)

Credit institutions maintain sound aggregate resilience, despite the relatively high volume of impairment losses in the adverse scenario, leading to a certain degree of capital consumption. Under the baseline scenario, credit institutions would be able to increase their CET1 ratio over the 2023-2025 horizon



SOURCES: Banco de España and Datastream.

a The net effect of the positive (negative) flows are indicated by the figure above (below) the corresponding bar. The initial and final CET1 ratios are presented as "fully-loaded". The other impacts include the change in RWAs between 2022 and 2025 and the effect of the ICO guarantees. Aggregate results include institutions supervised directly by both the SSM and the Banco de España.

b This variable includes net operating income in Spain and net income attributable to business abroad. Thus, the possible capital generated by the banking group as a whole is compared with the impairment losses in Spain and sovereign, which are the focus of these exercises.

c This variable shows the projection over the three years of the exercise of gross losses due to credit portfolio impairment for exposures in Spain and other types of loss (associated with the fixed-income portfolio, the management of foreclosed assets and the sovereign portfolio).

3 See the documentation in *EBA 2023 EU-wide stress test exercise.* Note that, although this year's use of the FLESB framework for macroprudential purposes shares scenarios with the EBA 2023 stress tests, there are differences between the two methodological frameworks. The main methodological differences include most notably the fact that the FLESB-based exercise includes additional adverse credit risk shocks with respect to the EBA exercise, in particular based on an estimate of potential latent impairment deriving from economic turmoil in the 2020-2022 period. Moreover, the EBA exercise assumes a static balance sheet, while the size of the balance sheet can oscillate dynamically in the FLESB exercise depending on the scenario. Also, unlike the EBA exercise, the FLESB does not consider specific shocks on operational risk. As regards the sample of institutions, the FLESB exercise, in the case of Spain, covers all significant institutions (SIs) and also the less significant institutions (LSIs), while the EBA exercise analyses eight SIs.

4 On this occasion, it corresponds to trajectories of macroeconomic and financial variables estimated in the December 2022 European national central bank projections exercise. In its exercises, the Banco de España has also considered subsequent projection scenarios, corresponding to September 2023, which show a slight improvement in estimated solvency with respect to the EBA's baseline scenario.

designed by the EBA include heterogeneous sector-specific gross value-added trajectories (real GVA). These trajectories reflect the heterogeneous sectoral impact of rising energy and other commodity prices and value chain disruptions.

The results obtained show that Spanish credit institutions maintain a sound aggregate solvency level for the 2023-2025 horizon, in both the baseline and the adverse scenarios. As shown in Chart 3.1, starting from a CET1 ratio of 12.8% in 2022, the analysed institutions improve their aggregate solvency in the baseline scenario and reach 14.0% in 2025 (+1.2 pp). In the adverse scenario, the aggregate CET1 ratio would fall to 9.5% by the end of the test's time horizon, resulting in capital consumption of 3.2 pp. However, the usual caution needs to be exercised in view of the individual institutions' heterogenous results. In particular, smaller institutions, under direct supervision of the Banco de España (LSIs), show greater resilience on the whole, favoured by a higher baseline solvency ratio, as well as a simpler business model and lower risk-taking. This group of institutions starts from a CET1 ratio of 18.2% in 2022 and ends the stress test in 2025 with a ratio of 21.4% (+ 3.2 pp) in the baseline scenario and 17.3% (-0.9 pp) in the adverse scenario[5].

Also, given the uncertainty of the current context, it is necessary for institutions, microprudential supervision and macroprudential policy to remain vigilant in order to be able to react quickly if there is a greater materialisation of the macro-financial risks identified, or others that may arise, with respect to the materialisation envisaged in the exercise.

3.1.2 Countercyclical capital buffer

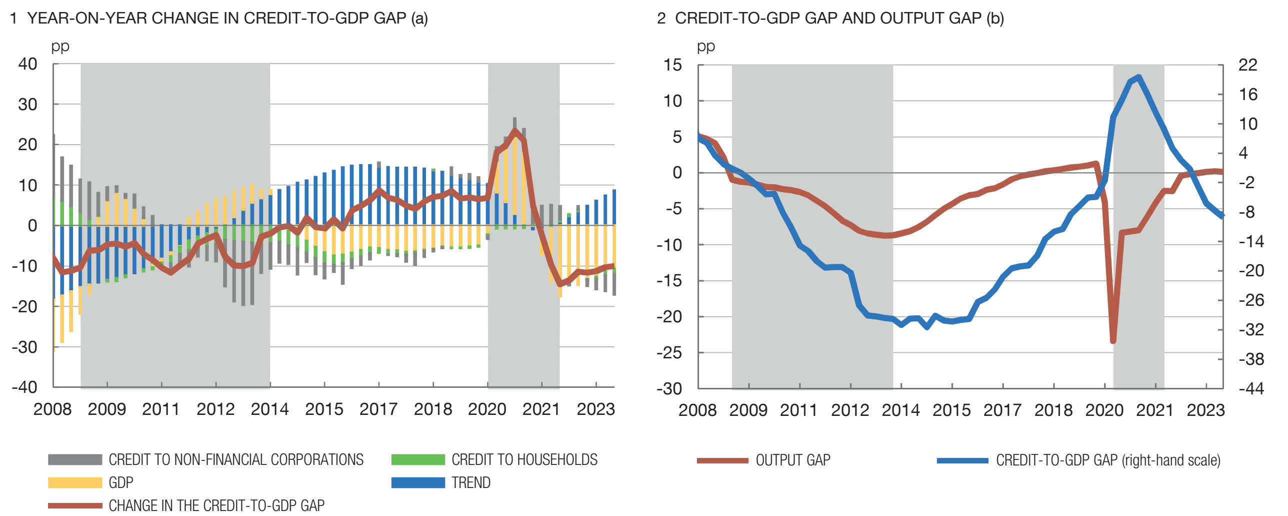
In 2023 the Banco de España maintained the CCyB rate at 0%. This capital requirement is designed to ensure that banks build up an additional capital reserve in financial upturns, when conditions are favourable. This buffer would be released subsequently in a downturn so as to absorb potential credit losses and help mitigate the contraction in credit flows to the real economy that is characteristic of such adverse situations. The decision to maintain the CCyB rate at 0% is based on the absence of signs of imbalances in the credit cycle from the indicators used by the Banco de España in its quarterly reviews of this buffer. In particular, the credit-to-GDP gap, the main benchmark indicator, measures the deviation of the aggregate indebtedness of the non-financial private sector of the economy (credit-to-GDP ratio) from a long-term equilibrium trend.[6] Its value declined progressively in 2023 to reach negative figures, due to growth in economic activity and, to a lesser extent, to the contraction of credit, mainly in non-financial companies, which commenced at the end of 2022 in a context of higher interest rates (see Chart 3.2.1). Other complementary indicators show signs consistent with maintaining the

5 These results differ from those shown in Chapter 2, which are calculated under assumptions for microprudential purposes, including the assumption of a static balance sheet. In contrast, the results in this chapter are prepared for macroprudential surveillance purposes, using the dynamic balance sheet method and including the estimation of potential latent impairment losses deriving from the economic turmoil in the 2020-2022 period linked to the COVID-19 crisis.

6 This trend is calculated using statistical procedures (using a one-sided Hodrick-Prescott filter). An increase in the credit-to-GDP gap above 2 pp is a warning sign of potential excessive credit growth.

Chart 3.2
CREDIT-TO-GDP GAP AND OUTPUT GAP

The credit-to-GDP gap continued to narrow in 2023, moving away from the 2 pp reference threshold above which credit cycle imbalances are considered to exist. However, its narrowing trend was brought to a halt by the decline in the equilibrium level of the credit-to-GDP ratio and the moderation in the growth of economic activity. The macro-financial environment has been surrounded by high uncertainty, influenced by inflationary pressures, monetary policy tightening and geopolitical tensions. Complementary indicators on the evolution of the macroeconomic environment to inform CCyB decisions, such as the output gap, do not show signs of build-up of systemic vulnerabilities.



SOURCES: Banco de España and Datastream.
NOTE: The shaded areas denote the latest systemic banking crisis (2009 Q1 - 2013 Q4)) and the crisis triggered by Covid-19 (2020 Q1 - 2021 Q4).

a The solid line represents the year-on-year change, in percentage points, of the credit-to-GDP gap. The latest observation is for September 2023.
b The credit-to-GDP gap is the difference between the credit-to-GDP ratio and the trend calculated using a one-sided Hodrick-Prescott filter. The gap is adjusted to adapt its calculation to a shorter cycle duration that is more consistent with the empirical evidence in Spain. To this end, a smoothing parameter of 25,000 is considered. This parameter is calibrated to match the financial cycles historically observed in Spain. The output gap is the percentage difference between observed GDP and potential GDP. Values calculated at constant 2010 prices. See P. Cuadrado and E. Moral-Benito (2016). "Potential growth of the Spanish economy". Occasional Papers No 1603, Banco de España. The latest observation is for September 2023.

CCyB rate at 0%. For example, the output gap, which measures the difference between actual and potential growth of the Spanish economy, remained relatively stable in recent quarters, at values close to equilibrium (see Chart 3.2.2).

The prevailing high macro-financial uncertainty throughout 2023 was also a relevant factor in the decision not to activate the CCyB. Following the global banking sector turmoil in March 2023, the systemic tensions in financial markets reduced. However, the macro-financial environment continued to be subject to high uncertainty, due to factors such as high inflationary pressures throughout much of the year, the tightening of monetary policy to address them, and geopolitical tensions which have increased since October 2023 with the emergence of a new flashpoint in the Middle East. This environment has increased the likelihood of less favourable macroeconomic scenarios, which again supports the decision to maintain the CCyB rate at 0%.[7]

7 See the current CCyB rate for exposures in Spain, together with the macro-financial indicators relevant to the decision, as well as the justification for the measure in the latest press release available on the Banco de España website.

3.1.3 Systemically important institutions

The Banco de España identifies the Spanish systemically important credit institutions each year and sets their macroprudential capital buffers. An institution is deemed systemic —globally or domestically— if, in the event of potential solvency problems, it could have a very adverse impact on the financial system and the real economy. Accordingly, an additional capital requirement is imposed on institutions to reinforce their resilience, incentivise prudent risk-taking and correct their potential competitive advantage in the funding market stemming from their systemic nature. Systemic importance is assessed by a set of variables that measure institutions' size, degree of interconnectedness, substitutability of services provided, complexity and cross-border activity.

At 31 December 2023, one G-SII, which is also an O-SII, and three other O-SIIs had been identified. In September 2023 the Banco de España announced the designation of four O-SIIs with their associated capital buffers in 2024,[8] while in December 2023 it announced the identification of one G-SII with its 2025 requirement (see Table 3.1).[9] Regarding capital buffers for O-SIIs, the Banco de España adapted its calibration methodology in 2023 to ensure consistency with the ECB's revised floor methodology for assessing buffers.[10] The Banco de España's new bucketing scheme between systemic importance scores and capital buffer ratios introduces a more demanding calibration at the top end than the ECB's floor framework (see Table 3.2). Under this scheme, the number of buckets also increased with respect to previous years from four to seven, with buffers ranging from 0.25% to 1.75%. As a result of the new buffer setting framework, the buffer required in 2024 for Banco Santander, SA is 1.25% and for BBVA, SA it is 1%, which represents an increase of 0.25 pp with respect to 2023 in

Table 3.1
SYSTEMICALLY IMPORTANT INSTITUTIONS AND ASSOCIATED CAPITAL BUFFERS

LEI code (a)	Institution	Designation (b)	Capital buffer requirement 2023	Capital buffer requirement 2024 (%)
5493006QMFDDMYWIAM13	Banco Santander, SA	G-SII and O-SII	1.00	1.25 (c)
K8MS7FD7N5Z2WQ51AZ71	Banco Bilbao Vizcaya Argentaria, SA	O-SII	0.75	1.00
7CUNS533WID6K7DGFI87	CaixaBank, SA	O-SII	0.50	0.50
SI5RG2M0WQQLZCXKRM20	Banco de Sabadell, SA	O-SII	0.25	0.25

SOURCE: Banco de España.

a The LEI code is the Legal Entity Identifier.
b G-SII refers to global systemically important institutions; O-SII refers to other systemically important institutions.
c In the event that an institution is designated as a G-SII or O-SII, the effective requirement is the largest of the two associated buffers. As Santander, S.A., the O-SII buffer (1.25%) prevails over the G-SII buffer (1.0%) in 2024.

8 See the press release of 29 September 2023 "The Banco de España updates the list of other systemically important institutions and sets their macroprudential capital buffer rates for 2024".

9 See the press release of 14 December 2023 "The Banco de España designates a Global Systemically Important Institution and sets its macroprudential capital buffer rate for 2025".

10 ECB. "Governing Council statement on macroprudential policies", of 21 December 2022.

Table 3.2
O-SII BUCKETING SCHEME IN SPAIN

Bucket	Systemic importance score (bp)	% Capital buffer (of RWAs) (a)
7	More than 5,500	1.75
6	4,450 – 5,500	1.50
5	2,700 – 4,449	1.25
4	1,950 – 2,699	1.00
3	1,300 – 1,949	0.75
2	750 – 1,299	0.50
1	Up to 750	0.25

SOURCE: Banco de España.

a RWAs refers to risk-weighted assets.

both cases. For CaixaBank, SA, and Banco de Sabadell, SA, the buffers are maintained at 0.5% and 0.25%, respectively.[11]

3.1.4 Other macroprudential tools

No systemic imbalances have been identified that would justify the activation of any of the other macroprudential tools at the Banco de España's disposal. In particular, the analysis performed regularly by the Banco de España has not shown sectoral imbalances that would require the activation of any sectoral macroprudential tool (sectoral CCyB, sectoral use of the systemic risk buffer or concentration limits). Nor has it been necessary to introduce limits on lending criteria, as there are no signs of a relaxation of lending standards for companies and households.

3.2 Macroprudential coordination with other authorities in Spain and in the SSM

The Banco de España is part of the Spanish macroprudential authority (AMCESFI),[12] **which is tasked with risk oversight for the Spanish financial system.** To this end, the Banco de España coordinates with the General Secretariat of the Treasury and International Financing, the CNMV and the DGSFP to hold regular discussions and exchanges of information on financial stability issues. The activities carried out by AMCESFI in 2023 will be summarised in its *Annual Report,* which also reviews the evolution by sector of the Spanish financial system

11 *Box 3.2 of the Financial Stability Report. Autumn 2023* provides more details on the implications for the Spanish case of this review of the ECB's methodological framework for assessing the capital buffers for O-SIIs.

12 AMCESFI was created by Royal Decree 102/2019 of 1 March 2019, and is configured as a collegiate body attached to the Ministry of Economy, Trade and Business, of which the National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds (DGSFP) also form part.

and analyses the direct and indirect interconnections between sectors of the financial system. The list of the Banco de España's participating members on AMCESFI's Council and Financial Stability Technical Committee is available on the AMCESFI website.

In 2023 AMCESFI published its first climate risk report.[13] This new report, which is to be published every two years, includes an analysis of the estimated impact of transition and physical risks on the Spanish financial system. The analysis suggests that these risks would be lower in a scenario where measures to foster the decarbonisation of the economy are taken in a timely and orderly manner and, at the same time, it points out that transition measures should be accompanied by mechanisms to mitigate the impacts on the most vulnerable households and on the reallocation of resources among sectors and among companies. The report also raises major challenges for financial authorities arising from the uncertainty about climate change, the limitations of currently used models and the need for additional data.

Within the framework of the Eurosystem and the Single Supervisory Mechanism (SSM), the Banco de España collaborates with other national authorities through the ECB's Financial Stability Committee (FSC). Participation in the FSC allows the Banco de España to address various issues of interest on recent developments in the area of identification and assessment of systemic risks and on the design and implementation of macroprudential policy actions in Europe. As usual, in 2023 the Banco de España notified the FSC of all its proposals for quarterly CCyB measures and annual G-SII and O-SII measures — each of which was non-objected by the ECB (see section 3.1).

The ECB prepared a report, co-authored with the European Systemic Risk Board (ESRB), on the development of a macroprudential policy framework for addressing climate change-related risks. The report, published in December 2023, considers: i) a surveillance framework, including indicators that can be used for assessing climate risks to financial stability; ii) a framework of macroprudential instruments, for both the banking and non-banking sectors, that address climate risk; and iii) extending the scope from climate-related risks to broader nature-related risks.

13 In compliance with the mandate established in Article 33(1) of Law 7/2021 of 20 May 2021 on climate change and energy transition.

Box 3.1

INITIATIVES TO STRENGTHEN RISK MONITORING IN THE COMMERCIAL REAL ESTATE SECTOR

The commercial real estate sector deals with the acquisition, financing, construction, development and management of properties in which economic activities are carried out. This type of property includes, among other categories, commercial premises, such as shops and hotels, offices and industrial buildings.[1] Supervisory authorities, at both the European and Spanish level, have followed this type of activity closely. Its importance derives mainly from the fact that these properties are a necessary production factor for companies in other sectors to carry out their activities. Also, by its very nature, the commercial real estate sector follows similar dynamics to the residential real estate sector. These properties, as in the case of housing, are potentially illiquid assets and can undergo processes of overvaluation and undervaluation that intensify both the financial upturns and the downturns in which systemic crises occur.

Given the importance of the commercial real estate sector, the ECB and the Single Supervisory Mechanism (SSM) commenced work in 2021 to strengthen its supervision.[2] On the macroprudential side, following careful analysis of this type of activity, at the end of 2022 the European Systemic Risk Board (ESRB) adopted Recommendation ESRB/2022/9 on vulnerabilities of the commercial real estate sector. This recommendation aims to improve the oversight of risks in this sector, to ensure that financial institutions adequately address these risks and to ensure that all supervisory authorities (banking and non-banking), have the necessary prudential tools at their disposal and apply them appropriately.

The recommendation is divided into four sub-recommendations.[3] This box focuses exclusively on sub-recommendation A, as the Banco de España is its main target in Spain, and the deadline for its compliance is the nearest.[4] This sub-recommendation calls for the authorities to closely monitor current and emerging vulnerabilities related to commercial real estate, by assessing the cyclical stage of the commercial real estate market and monitoring developments in commercial property prices, the income flows generated by commercial real estate and the financing conditions and sources in this sector, as well as the interconnectedness with other economic and financial sectors.

The Banco de España has adopted this recommendation and has launched a series of tasks to reinforce its monitoring of this sector. Firstly, a project has commenced in order to assess the level of imbalances in commercial real estate prices at different points in time. Secondly, work has intensified on the analysis of the various data sources available to the Banco de España that are relevant to the analysis of the commercial real estate market, which will allow close monitoring of the evolution of transactions and prices in this sector and of the financing of the companies that carry out this type of activity, together with information on their balance sheets and their interconnections with the rest of the economy and interlinkages between countries.[5]

As regards the bank financing of this sector, the weight of commercial real estate lending by Spanish institutions was close to 4% of total lending at the end of 2023.[6] This proportion is lower than in Spain's main neighbouring countries. For example, for the European Union as a whole, banks' exposures accounted for just over 6% of total lending at the end of last year. If banks' exposure to this sector is taken on an individual basis, in the case of Spanish institutions, this lending accounted for 6.3% of GDP at 2023 year-end.

The work that has already been carried out includes most notably the development of a hedonic price index for commercial real estate. The hedonic nature of the indicator guarantees the possibility of monitoring the price evolution of properties with homogeneous characteristics.[7] Chart 1 shows the evolution of this index for the commercial real

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1 Residential buildings for rent can also be considered as commercial activities.

2 See "Commercial real estate: connecting the dots", article published in the ECB's *Supervision Newsletter* on 17 August 2022.

3 Sub-recommendation A, addressed to financial stability authorities; sub-recommendation B, addressed to supervisory authorities; sub-recommendation C, addressed to competent authorities; and sub-recommendation D, addressed to the European Commission.

4 In particular, the Banco de España must report on compliance by 31 March 2024 at the latest. A new assessment of this sub-recommendation will be carried out on 31 March 2026.

5 These sources would be the Banco de España's Central Credit Register, the Association of Registrars (with information on real estate transactions) and the Central Balance Sheet Data Office (with information on companies' balance sheets). Information on securitisations of commercial real estate backed loans granted is also available via the *European DataWarehouse.*

6 Based on consolidated information from the EBA's risk monitoring framework.

7 This is achieved through regressions that take into account categorical variables relating to the location of the property or other characteristics. For more details, see M. Lamas and S. Romaniega. (2022). "Designing a price index for the Spanish commercial real estate market". Occasional Papers, 2203, Banco de España.

Box 3.1
INITIATIVES TO STRENGTHEN RISK MONITORING IN THE COMMERCIAL REAL ESTATE SECTOR (cont'd)

In year-on-year terms, commercial property prices fell moderately until September 2023 (although since March of this year there has been an increase), and there was a certain loss of momentum in the business indicators (sales and loans).

Chart 1
PRICE INDEX FOR COMMERCIAL REAL ESTATE SECTOR (a)

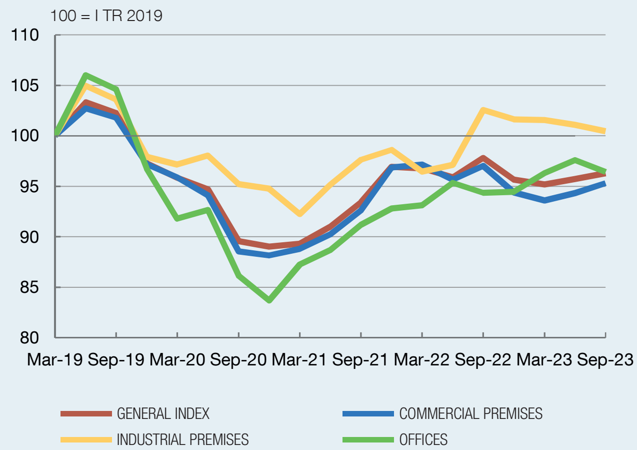
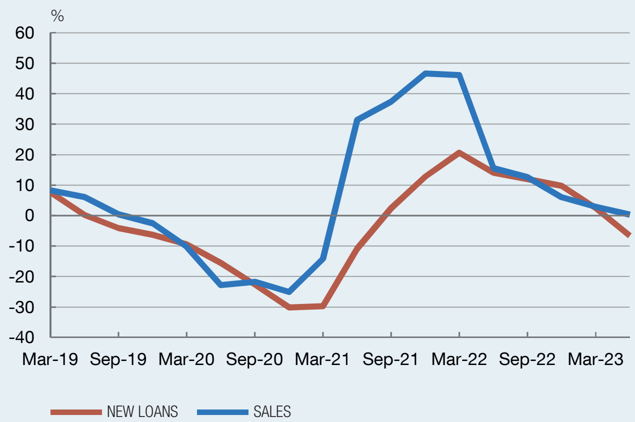


Chart 2
YEAR-ON-YEAR CHANGE OF COMMERCIAL REAL ESTATE SALES AND LOANS



SOURCES: Banco de España and Association of Registrars.

a Based on estimates with a hedonic regression model in each stratum. The aggregate index is the average weighted by the relative weight of transactions carried out in each segment (4% offices, 78% commercial premises and 18% industrial premises).
b Sales of commercial premises, offices and industrial premises. The new mortgages considered are secured by these properties. The information on sales and mortgages for 2023 Q3 is still partial and not depicted in the chart. Moreover, the annual changes shown are the average year-on-year rates for the last four quarters.

estate sector as a whole and for some of the most representative types of establishments. As can be seen in the chart, commercial real estate prices suffered during the pandemic, although in 2021 they recovered to their pre-pandemic level. In 2023, however, there was a moderate price contraction (with the information available in Q3 2023, the year-on-year change in the price index was -1.6%).

The price behaviour of this type of establishment contrasts with the sector's activity indicators (Chart 2). According to information from the Association of Property Registrars *(Colegio de Registradores de la Propiedad),* and with data up to Q2 2023, in the last year there was a year-on-year fall of 2.8% in the number of new sales of these properties. At the same time, this period saw a year-on-year decrease of 24.8% in new loans secured by this type of property. If this decline in activity was to consolidate persistently, it could have wider implications for commercial real estate prices and for economic activity and financial stability.[8] In addition, it should be noted that the balance of commercial real estate loans on the balance sheet of Spanish banks is relatively small compared to the balance of residential loans: it accounted for 8% of banks' total private sector loan balance at the end of 2023, as compared to 44% for residential real estate loans.[9]

8 In the event of falling real estate prices, the value of real estate collateral declines, which affects agents' lending capacity or, in the case of defaults, loan recovery rates. Moreover, a less dynamic commercial real estate sector, which encompasses the activity of developers and builders, could have some impact on employment and reduce household incomes, implying a risk to financial stability.

9 Based on supervisory information from the Banco de España (individual data, businesses in Spain).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4

SUPERVISION OF INSTITUTIONS’ CONDUCT

SUPERVISION OF INSTITUTIONS' CONDUCT

CULTURE OF CONDUCT

The conduct-related supervision function should be geared towards bolstering institutions' culture to ensure honest and impartial behaviour and to strengthen the framework of trust in the relationship between institutions and their customers

PREVENTIVE SUPERVISION AND SUPERVISORY PRIORITIES IN 2023

The aim is to promote a preventive supervision approach, strengthening supervisory expectations and ongoing monitoring. In 2023, the supervisory priorities were focused on: i) measures in relation to groups facing difficulties; ii) best marketing practices; and iii) strengthening internal controls

GROUPS FACING DIFFICULTIES

Compliance with measures to mitigate the effects of rising interest rates on mortgage transactions was inspected and the application of the basic payment account regulations was verified

PRODUCT MARKETING

Within the appropriate marketing of products and services, priority has been given to the analysis of the deferral of payments at the point of sale, responsible lending and products ancillary to mortgage loans, as well as payment account switching and the fee information document

STRENGTHENING INTERNAL CONTROLS

Special emphasis has been placed on controls on fraud risk mitigation measures in the use of cards and in payments made through digital channels, customer service department information on websites and commercial communication policies

SUPERVISORY ACTIVITIES AND MEASURES IN 2023

The activities comprise both supervisory actions and the monitoring of supervisory measures and other monitoring. The following supervisory measures were adopted during 2023: 1 sanctioning proceeding initiated, 57 advertising requirements, 44 requirements on other matters and 76 recommendations

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The exercise of the Banco de España's supervisory functions and responsibilities on matters of conduct, information transparency and customer protection is not limited to verifying compliance with the applicable regulations. The fundamental objective of this task is to promote a culture of compliance in institutions, prioritising the establishment of business models and organisational structures in which the relationship with the end customer takes precedence.

Of particular relevance in this regard is the recent amendment of Law 10/2014,[1] through Law 18/2022,[2] introducing a general principle or duty of conduct for institutions to act in an honest, impartial, transparent and professional manner, with respect for the rights and interests of customers. The amendment also requires credit institutions to define and establish appropriate organisational policies and procedures to ensure the effective application of and due compliance with the organisational and disciplinary rules governing institutions' conduct and bank customer protection.

Increasingly, supervisory attention is focused on assessing, with due respect to the principle of proportionality, the institution's internal control framework, thereby helping to improve the conduct of supervised institutions and to identify best market practices, ultimately leading to more effective conduct supervision.

4.1 Conduct-related supervisory activity

In 2023, the Banco de España's conduct strategy was structured around two central factors: the definition of supervisory priorities based on conduct risks with potential impact on customers; and the promotion of a preventive supervision approach, strengthening ongoing monitoring of institutions and conduct risks.

The information was obtained from the complaints and queries resolved by the Banco de España, details of which can be found in the Complaints Report. Thus, this information feeds into both the process of calibrating the conduct risk of the various institutions and the definition of supervisable targets as part of the supervisory planning. Also, the complaints help assess the effectiveness of the corrections suggested to or imposed on institutions by the supervisor and the need for these to be supplemented by regulatory actions.

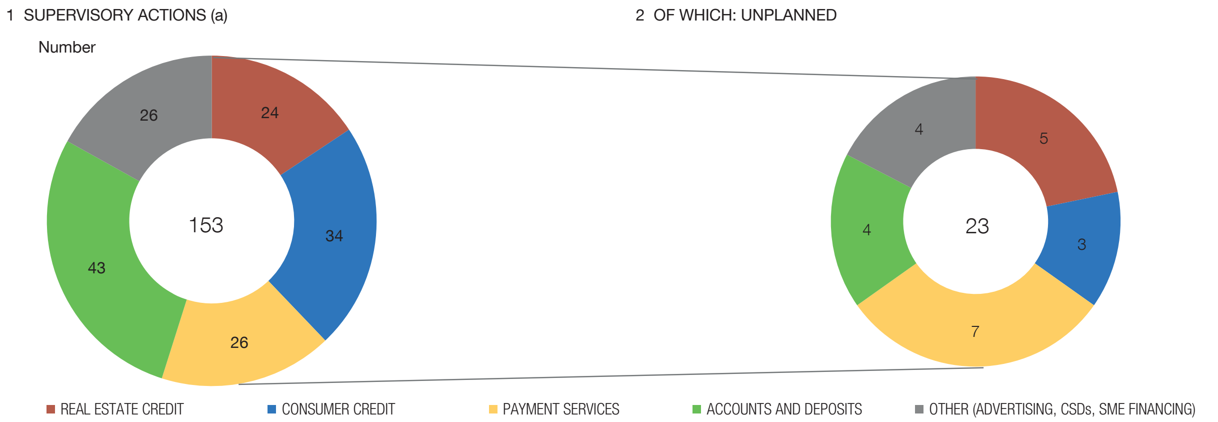
In a context of rising inflation and interest rates and market instability, supervisory priorities were focused on:

1 Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions.

2 Law 18/2022 of 28 September 2022 on the creation and growth of companies.

Chart 4.1
CONDUCT-RELATED SUPERVISORY ACTIONS IN 2023 BY SUBJECT MATTER

Supervisory actions were focussed mainly on the areas of activity relating to accounts and deposits, consumer credit, payment services and real estate credit.



SOURCE: Banco de España.

a Of these supervisory actions, 109 were initiated before the beginning of 2023.

— compliance with the alleviation measures established in relation to groups facing difficulties;

— appropriate marketing of products and services, especially those marketed through remote channels; and

— improvement of institutions' internal controls, with particular emphasis on the control measures implemented to address the risk of fraud in the use of cards and in payments made through digital channels.

In line with the defined strategy, actions were planned during 2023 aimed at achieving these three objectives, although unplanned actions were also carried out to respond to ad hoc supervisory needs. Chart 4.1 shows both types of action separately, with the breakdown by subject matter.

An important part of supervisory work is identifying market trends and best market practices which, based on evidence, feed into an increasingly comprehensive and integrated legal framework, ultimately leading to more effective supervision. Thus, with regard to granting consumer credit, the *Guidelines on the governance and transparency of revolving credit*[3] were drawn up and good practices were identified in relation to credit in the form of tacit current account overdrafts (see Figure 4.1). The knowledge gained also fed into the technical opinion conveyed during the review work on European consumer credit

3 These guidelines, published in December 2023, contain the best market practices identified in the exercise of the supervisory function and the criteria and procedures that the Banco de España considers appropriate for compliance with the rules applicable to the granting of this type of credit.

legislation,[4] developed in response to market developments (see Box 4.2), thus helping improve the regulation of the financial sector in line with European Union (EU) principles and best practices.

Lastly, as an essential complement to the conduct-related supervisory strategy, and in the ongoing search for greater supervisory impact in this area, the exchange of information and the transmission of relevant messages to supervised institutions is fostered, including, among other aspects, the communication of supervisory priorities and expectations.

4.1.1 Ongoing monitoring

Ongoing conduct monitoring is a key part of supervisory planning. This monitoring provides greater knowledge of business models, commercial strategies and the financial market in general, which is crucial for identifying potential conduct risks, designing a preventive supervisory strategy, planning supervisory actions and establishing supervisory criteria on specific conduct matters.

In 2023, monitoring was carried out individually at institutions with the largest market share, and in groups at the rest of the institutions, depending on the type of activity and business model. This monitoring assesses institutions' compliance with transparency and customer protection regulations, their commercial strategy, organisational structure, product offerings and the handling of customer complaints.

Regular meetings with institutions are an essential part of the monitoring. In 2023, contact with institutions was intensified with the aim of facilitating the transmission of supervisory criteria and priorities and enhancing supervisory knowledge. This interaction with institutions also allowed institutions to modify certain aspects prior to the adoption of supervisory measures, which confirms the effectiveness of these collaborative mechanisms between supervisor and institutions.

In line with the established supervisory priorities, the monitoring paid particular attention to the following aspects: the treatment of mortgagor debtors without resources (see Box 4.1); the location of customer service department (CSD) information on institutions' websites; the provision of payment account switching services and the provision and content of the payment account fee information document; and the problem of fraudulent transactions.

Within the framework of ongoing monitoring, it is also worth noting the supervisory activity aimed at reviewing institutions' organisational policies and procedures in two specific areas of action: advertising activity, and the functioning of CSDs.

4 Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC (CCD2).

In 2023, with regard to the supervision of advertising, the verification of internal procedures and controls that ensure adequate management of the risks derived from this activity was one of the key aspects, together with the review of the content and design of adverts. In this respect, the number of adverts classified as correct increased and the number of withdrawal or rectification requests decreased thanks to the evolution of regulations (which have been focused on strengthening internal controls since 2010 and, especially, since 2020) and to the supervisory work carried out in recent years.

With regard to the supervision of CSDs, the review of their rules of procedures and the monitoring of their activity are particularly relevant. Also, special attention is paid to the effective implementation of the practices, methodologies and procedures developed in the *Guidelines on the organisational and operating criteria of customer service departments at institutions supervised by the Banco de España,* published in 2021.[5] In relation to this last-mentioned matter, there is a gradual implementation of the best practices set out in the guidelines.

4.1.2 Inspection actions

The annual plan of supervisory activities for 2023 was drawn up on the basis of the supervisory priorities defined for the year which are focused on the monitoring of alleviation measures for groups facing difficulties, the appropriate marketing of products and services and the improvement of internal controls.

With regard to the verification of compliance with the legislative measures established to support groups facing difficulties, on the one hand, in the mortgage area, inspections were carried out to verify the application of the measures[6] to mitigate the effects of the rise in interest rates and, on the other hand, compliance with the basic payment account regulations was verified. Box 4.1 has more information on this last-mentioned action.

As regards the review of the requirements applicable to the marketing of products and services, due to significant changes in the consumer credit market (see Box 4.2), the activity was focused on enhancing knowledge of the technological solutions used by institutions for deferred payments at the point of sale and on verifying the implementation of responsible lending principles. Also in relation to consumer credit, actions under way related to the marketing of loans granted in the form of overdrafts on demand deposits were finalised (see Figure 4.1).

In relation to the development of new technological solutions for deferred payment at the point of sale, a cross-institutional action was carried out making it possible to

5 These guidelines are available at the following link: https://app.bde.es/clf_www/leyes.jsp?id=193122&tipoEnt=0

6 These measures are basically aimed at facilitating the novation or subrogation of variable rate mortgage contracts, through the exemption or suspension of the application of fees or compensation for the novation or early repayment of loans, provided that the conversion of the variable interest rate to a fixed rate is agreed.

Figure 4.1
STRENGTHENING THE TRANSPARENCY REQUIRED IN TACIT OVERDRAFTS AND IN THE CHARGE FOR THE COST OF CLAIMING DEBIT POSITIONS (CCDP)

NEW GOOD PRACTICE STANDARDS APPLICABLE TO TACIT CURRENT ACCOUNT OVERDRAFTS AND CHARGE FOR THE COST OF CLAIMING DEBIT POSITIONS (CCDP)

As a result of the cross-institutional supervisory action involving 22 institutions, regarding compliance with obligations established in relation to tacit overdrafts granted to individuals, different practices in the treatment of such overdrafts and the charge for CCDP could be identified. The analysis made it possible to define new criteria for good practices.

Opening and settlement of the overdraft

- Give the customer the option to disallow the charging of bills when overdrawn
- Report on the period for regularising the debit balance before settling the overdraft and the possibility of CCDP being passed on

- Settle the overdraft before requiring it to be recovered
- After settlement, set a minimum time limit for paying the balance before conducting a claim process involving the charging of CCDP
- Unpaid and claimed overdrawn balances shall not be re-settled; therefore, they will not lead to new fees or CCDP, regardless of any late payment interest
- In the calculation of the largest overdrawn balance for the purpose of calculating the annual percentage rate of charge for tacit overdraft provided for in Rule 13(7)(e) above, the amounts corresponding to any fees or charges for services passed on by the institution (including those resulting from the actual settlement of an overdraft in respect of these items) should not be included
- The following may not generate or increase an overdraft: (I) the reversal of fees or expenses with a date subsequent to their charge, (ii) the overdraft entry of loan or credit instalments of the institution itself, (iii) the allocation to a cash deposit or ATM deposit of a value date later than the date on which the deposit was made

CCDP treatment

- To be able to pass on CCDP:
  - The appropriate claim procedures must have been performed and the overdraft must have been settled
  - The debtor balance must not yet be regularised
- If a CCDP is issued prior to the settlement of the overdraft, this cost shall be deemed to be part of the items passed on by the provision of the tacit overdraft service itself and, therefore, of the cost of the credit for the purposes of Rule 13(7) (e) of Circular 5/2012

SOURCE: Banco de España.

ascertain existing practices and business models and to identify a series of information transparency weaknesses related to the quality of the explanations offered and the delivery of pre-contractual information. As a result of the action, various supervisory measures were adopted to correct the incidents detected, compliance with which is subject to supervisory monitoring.

With regard to the correct application of responsible lending principles and the implementation of appropriate marketing practices in institutions' lending activity, the weaknesses identified during the supervisory work were focused on the following areas: the procedures to assess the customer payment capacity, staff training, information provided to customers facing financial difficulties and the promotion of active debt renegotiation policies. The areas for improvement detected did not require the adoption of corrective measures; however, they were communicated to the institutions concerned, seeking effective and improved compliance with these principles.

As in previous years, visits were made to bank branches to verify that the staff dealing with customers have sufficient knowledge of payment account regulations and convey

this knowledge with due clarity to customers. As a result of these visits, there was a positive evolution in institutions' commercial practices, which could signify an improvement in the training they provide to their employees.

Another supervisory focal point in 2023, in view of the increase in fraud in card payments and payments through digital channels, was the internal control procedures put in place by institutions to mitigate this risk. In this regard, various supervisory actions were carried out to ascertain and assess how they manage the risk of fraud vis-à-vis their customers —for example, by verifying that customer communications are carried out in accordance with the regulations— and to check the degree of control of their fraud protection measures and systems, including customer awareness programmes and employee training. As a result of these actions, it has become evident that institutions have significantly improved the design of customer communications, awareness programmes and employee training.

Lastly, in the current economic climate, it is to be expected that there will be adaptive decisions by customers and that institutions will have to manage default situations. Therefore, it will be necessary to strengthen the oversight of institutions' competitive practices and behaviour in order to deal with this context.

4.2 Supervisory measures

4.2.1 Adoption of supervisory measures

The supervisory measures adopted in 2023 include most notably the initiation of 1 sanctioning proceeding and the issuance of 101 requirement letters and requests for the cessation and rectification of conduct. As for the requirement letters and requests for the cessation and rectification of conduct, 57 were issued in the area of advertising activity, requesting the withdrawal or rectification of advertising pieces for not complying with regulations, 18 in the framework of the cross-institutional action on institutions' internal advertising registers and 9 on the action related to technological solutions used by institutions for payment deferral at the point of sale. The remaining letters were issued in the area of supervisory activities on real estate credit, consumer credit and payment services.

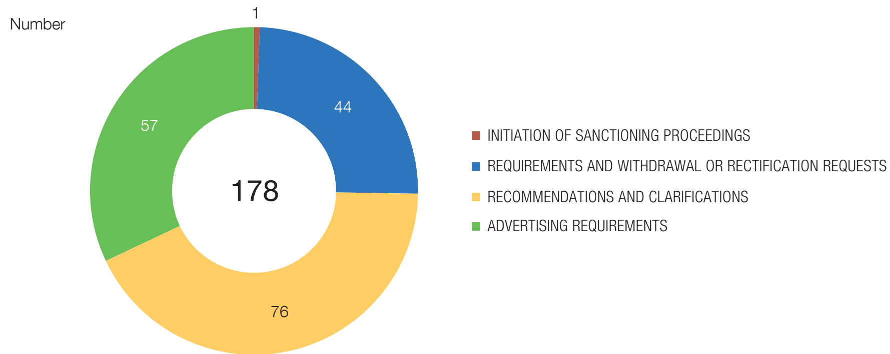
Also, 76 letters with recommendations and clarifications were sent to institutions in relation to the treatment applicable to certain products, transactions, actions or specific situations. These include most notably 25 letters with clarifications on the application by institutions of the responsible lending principles in consumer credit and 20 letters with recommendations and clarifications in relation to loans granted in the form of overdrafts on demand deposits.

Chart 4.2 includes a breakdown of the supervisory measures adopted in 2023.

Chart 4.2

SUPERVISORY MEASURES ADOPTED AND ADVERTISING REQUIREMENTS IN 2023

In 2023, as a result of the supervisory actions carried out, 1 sanctioning proceeding was initiated, and 101 requirements letters and withdrawal or rectification requests were issued, of which 57 were related to the framework of the supervisory activity relating to advertising, and 76 recommendations and clarifications letters were issued.



SOURCE: Banco de España.

Lastly, in addition to the adoption of the above supervisory measures, the supervision of CSDs led to letters being sent to institutions and customer ombudsmen as a result of the verification of their rules of procedures and other issues regarding their head officers, and to other supervisors, in the case of the verification of the CSD rules to which other institutions under their supervision adhere. Specifically, in 2023, 287 letters were sent to institutions, 4 to ombudsmen and 3 to the CNMV.

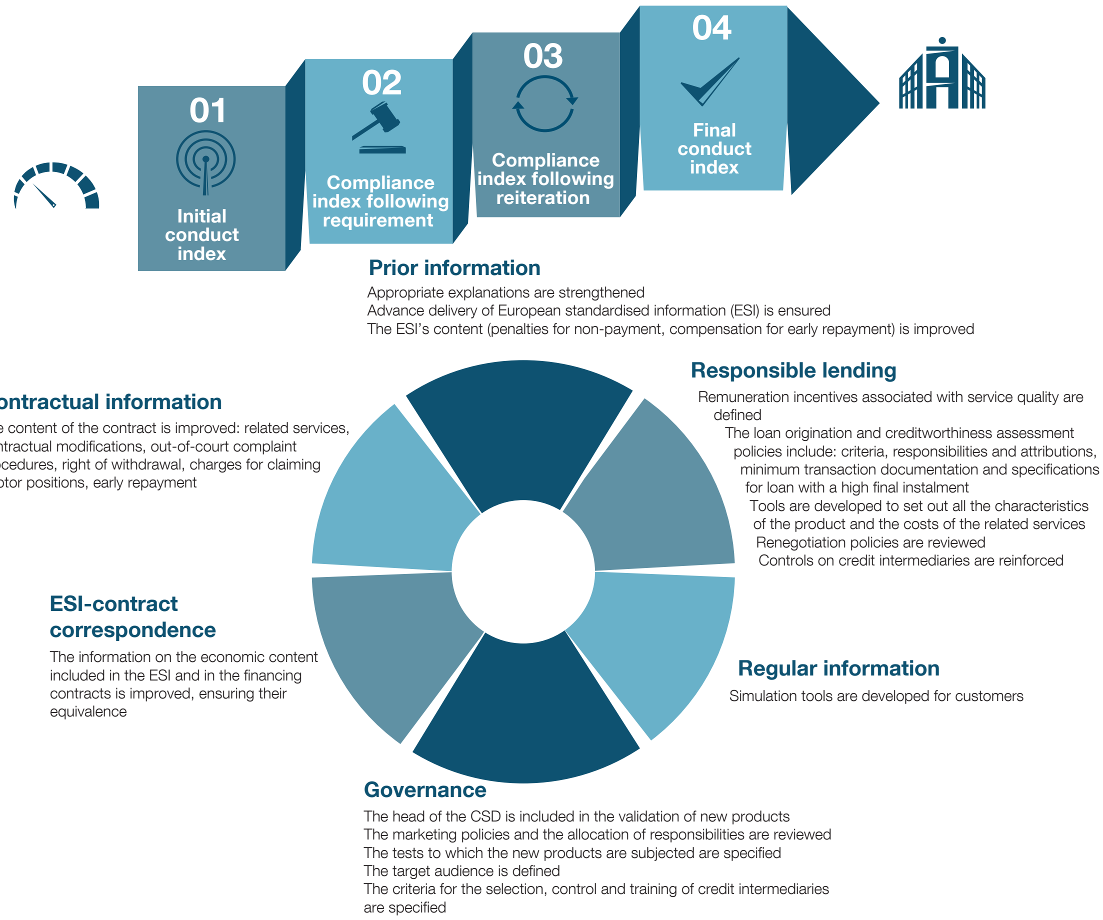
4.2.2 Monitoring and effectiveness of supervisory measures

In 2023 effective compliance with the supervisory measures adopted as a result of the various supervisory actions performed was verified, with an overall positive assessment. The monitoring of compliance with these measures is the final stage in the process of supervising institutions' conduct. In turn, the knowledge gained from this serves to inform supervisory planning and promote best market practices, thereby contributing to the ongoing strengthening of the conduct of supervised entities.

Specifically, last year work was carried out on monitoring compliance with the supervisory measures derived from actions related to the appropriate marketing of payment accounts (remote contracting, account switching service, notification of contractual modifications and basic payment account), consumer credit (financing for car purchases and loans granted in the form of tacit overdrafts), the information reported to the Banco de España by institutions in relation to Annex 9 of Circular 5/2012, for the preparation of benchmark indices, and institutions' internal advertising register. Further detail on the effectiveness of the measures adopted by institutions in relation to financing for car purchases and internal advertising registers can be found in Figures 4.2 and 4.3, respectively.

Figure 4.2

THE EFFECTIVENESS OF THE SUPERVISORY ACTION ON FINANCING FOR CAR PURCHASES. MAIN CORRECTIONS



SOURCE: Banco de España.

Figure 4.3

INTERNAL ADVERTISING REGISTERS

In 2023 the action on internal advertising registers, which began in 2022, was finalised with the aim of verifying part of the institutions' internal controls, which allow for an adequate management of the risks arising from this advertising activity. The weaknesses identified were communicated to the institutions, which have taken measures to strengthen their procedures, workflows and controls

Measures adopted

Improvement of internal procedures

— Training and awareness-raising of staff in charge of registers

— New controls in the workflow

Improvements to the IT registry tools used

— Incorporation of automatic controls

— Registry management applications

Strengthening controls of collaborators

— Incorporation of specific procedures for relations with collaborators

— Strengthening the control of advertising disseminated by third parties

SOURCE: Banco de España.

Box 4.1

PROMOTION OF BEST MARKET PRACTICES IN THE IMPLEMENTATION OF THE MEASURES ESTABLISHED IN RELATION TO GROUPS FACING DIFFICULTIES

Code of Good Practice

In 2023, in the framework of the recurrent monitoring of supervised institutions, special attention was paid to the financial difficulties of mortgagor debtors without resources and to compliance with the regulatory framework established in Royal Decree-Law 19/2022[1] and Royal Decree-Law 6/2012,[2] which provide for various mechanisms to protect mortgagor debtors, establishing an access regime and a series of measures set out in their respective codes of good practice.

Thus, in 2023 a specific review was carried out on institutions' compliance with obligations related to: i) application of the measures provided for in the codes of good practice; ii) adherence to the codes; iii) communication of their content to customers; and iv) submission of confidential information to the Banco de España relating to both codes. After reviewing the information received, it was found that the institutions assessed showed room for improvement in terms of the information available on the two codes on their websites, communications to customers and staff training. In addition, the autumn issue of the *Financial Stability Report* commented in detail on institutions' use of both codes.

Basic payment account

The basic payment account responds to the need to promote financial inclusion in the European Union by facilitating consumers' access to minimum banking services. Spanish credit institutions have been obliged to offer this product since the entry into force of Royal Decree-Law 19/2017[3] and its implementing regulations. In the last year, several supervisory actions have been carried out in relation to the marketing of the basic payment account; it has been noted that, in general, institutions provide information on this product both on noticeboards and on their websites and that employees are aware of its existence, although a certain lack of knowledge has been detected with regard to the characteristics of this type of account, especially the free-of-charge scheme for certain groups, and in the prior information provided to applicants. These actions have made it possible to identify best market practices, including the establishment of mechanisms for identifying groups facing difficulties to whom this account is offered.

The number of basic payment accounts opened in Spain is not high, which may be due to institutions' not being proactive when it comes to offering this product, but also to the high level of banking penetration and the existence of other marketed products with similar characteristics. On the other hand, the refusal rate for opening basic payment accounts recorded in institutions' systems is low; the main reason for refusal is that the customer already has another current account.

Promoting an agreement between the institutions and the Public Prosecutor's Office

In relation to measures to support the legal capacity of persons with disabilities in the area of banking, in 2023 the Public Prosecutor's Office and the main banking associations entered into an agreement, accompanied by the Banco de España, as an observer, to guarantee the autonomy of persons with disabilities in relation to banking services and products. As a result of this agreement, information has been made available to the public on the Public Prosecutor's Office website.

1 Royal Decree-Law 19/2022 of 22 November 2022, which establishes a Code of Good Practices to alleviate the rise in interest rates on mortgage loans on primary residences, amends Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgagor debtors without resources, and adopts other structural measures to improve the mortgage loan market.

2 Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgagor debtors without resources.

3 Royal Decree-Law 19/2017 of 24 November 2017 on basic payment accounts, payment account switching and comparability of fees.

Box 4.2

REGULATORY AND SUPERVISORY RESPONSE TO CHANGES IN THE CONSUMER CREDIT MARKET

In recent years, rapid technological advances and digitalisation have contributed to generating significant changes in the consumer credit market, on both the supply and demand side. The credit offered to consumers has evolved and diversified considerably, due to factors such as the emergence of new products and changes in consumer behaviour and preferences.

Thus, the use of new technologies has led to the entry of new players in the consumer credit sector, such as crowdfunding platforms and service providers commonly referred to as "buy now, pay later".[1] Moreover, the offer of deferred payment facilities[2] by the major online service platforms, with access to a large customer base, could lead consumers to unthinking consumption and distort competition, given their ability to generate network effects,[3] and, therefore, the European legislator has identified the need to introduce certain limits on the use of these facilities by goods and service providers.[4]

As regards the legal framework, it is still not fully harmonised, leading to some divergences in the EU

Figure 1
REGULATORY AND SUPERVISORY RESPONSE IN THE CONSUMER CREDIT MARKET

REGULATION AND SUPERVISORY GUIDELINES	**Directive (EU) 2023/2225** of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC (CCD2)	The aim is to strengthen consumer protection and remove potential obstacles to the cross-border consumer credit market Most relevant aspects: (i) extends its scope to agreements which had been excluded from the previous regulation, (ii) provides for consumer credit intermediaries and creditors to be subject to a recognition and registration procedure and subject to supervision, and (iii) provides for measures to limit borrowing rates, annual percentage rates or total costs of the credit to the consumer
	Guidelines on the governance and transparency of revolving credit for institutions subject to Banco de España supervision	It includes the best market practices identified in the exercise of the supervisory function, and the criteria and procedures that the Banco de España considers adequate for compliance with the rules applicable to the granting of revolving credit
SUPERVISION	**Technological solutions for deferral of point-of-sale payments** Supervisory action on 10 institutions	*Observed practices*: Different kinds of solutions; Prevalence of online channel; Target audience: 31-45 years; Amount less than €200 *Adoption of supervisory measures*: Adequate explanations; Provision of pre-contractual information
	Responsible lending Supervisory action on 25 institutions	*Areas with weakness detected*: Procedures for assessing customers' payment capacity, their interests and needs; Staff training, especially intermediaries; Active debt renegotiation policies and information to customers in financial difficulties

SOURCE: Banco de España.

1 BNPL (buy now, pay later).

2 Commercial practices whereby the supplier of goods or services grants the consumer a period of time to pay for the goods or services without interest and at no other cost. These commercial practices, which are common and generally advantageous for consumers, have so far been excluded from the regulatory perimeter, as long as there is no third party offering the credit.

3 The network effect, or pull effect, arises when a good or service is more valuable to a user the more users use the same or other compatible goods or services.

4 Recital 17 of Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC.

Box 4.2
REGULATORY AND SUPERVISORY RESPONSE TO CHANGES IN THE CONSUMER CREDIT MARKET (cont'd)

internal market. In some jurisdictions, an authorisation or specific registration is required in order to carry out the consumer loan origination activity, while in other cases there is no vetted access to activity and no prudential or conduct of business requirements are necessary to carry out the activity. This situation could generate distortions in a slowly growing supply of cross-border credit as a result of digitalisation and, consequently, in competition and in the ability of consumers to take advantage of this supply.

Figure 1 details the main regulatory and supervisory response to these developments.

5

OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

TARGET OVERSIGHT

Monitoring of the migration to the new TARGET system was completed

SNCE SUPERVISION

A new SNCE regulation was approved. A total of 11 SNCE operating instructions and 4 amendments to the basic rules of other complementary services obtained a favourable assessment

CARD PAYMENTS OVERSIGHT

STMP was identified as a prominently important retail payment system and is subject to oversight by the Banco de España

PAYMENT STATISTICS

Instant credit transfers represent over 52% of total transfers in Spain, while in the European Union they account for just over 15%, according to statistics from the second quarter of 2023

OVERSIGHT FRAMEWORK

The Eurosystem's cyber resilience strategy for financial market infrastructures was re-viewed. Apple Pay and Google Pay are considered as payment arrangements subject to Eurosystem oversight

OVERSIGHT OF SECURITIES INFRASTRUCTURES

A total of 6 favourable reports were issued in relation to various adaptations to BME Clearing regulations

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Most trade and financial transactions are cleared and settled through financial market infrastructures. Given the central role they play, central banks are entrusted with their oversight and, in some cases, their supervision.

5.1 Oversight of payment systems and instruments

Ensuring the efficiency and smooth functioning of payment systems is a responsibility of central banks, which also includes oversight of the payment instruments that allow end users to transfer funds.

5.1.1 Pan-European payment systems

Monitoring of the Eurosystem T2-T2S consolidation project was completed in 2023, culminating in the migration to the new TARGET system, which now consists of three services: i) T2, for the real-time gross settlement of euro payments; ii) TIPS, for the settlement of SEPA instant credit transfers;[1] and iii) T2S, for the settlement of securities.

Under the leadership of the ECB, the Banco de España participates in the Eurosystem's cooperative oversight of the TARGET services. TARGET is considered to be a systemically important payment system under the SIPS Regulation.[2]

The evolution of the T2 service, both TARGET and the Spanish TARGET2-BE, is presented in Chart 5.1. In 2023, the number of transactions increased slightly, while the amounts settled decreased, mainly due to the fall in value of interbank transactions. The Spanish component TARGET-BE accounted for just over 6% of the total number of transactions processed in the T2 service, while in terms of value it reached a share of around 4% of the total.

In 2023 it was noted that most of the milestones of the action plan to comply with the **recommendations issued by an external auditor and by the oversight and internal audit functions,** in response to the incidents experienced by TARGET2 in 2020, had been completed, and that the remaining actions would be finalised in the first quarter of 2024.

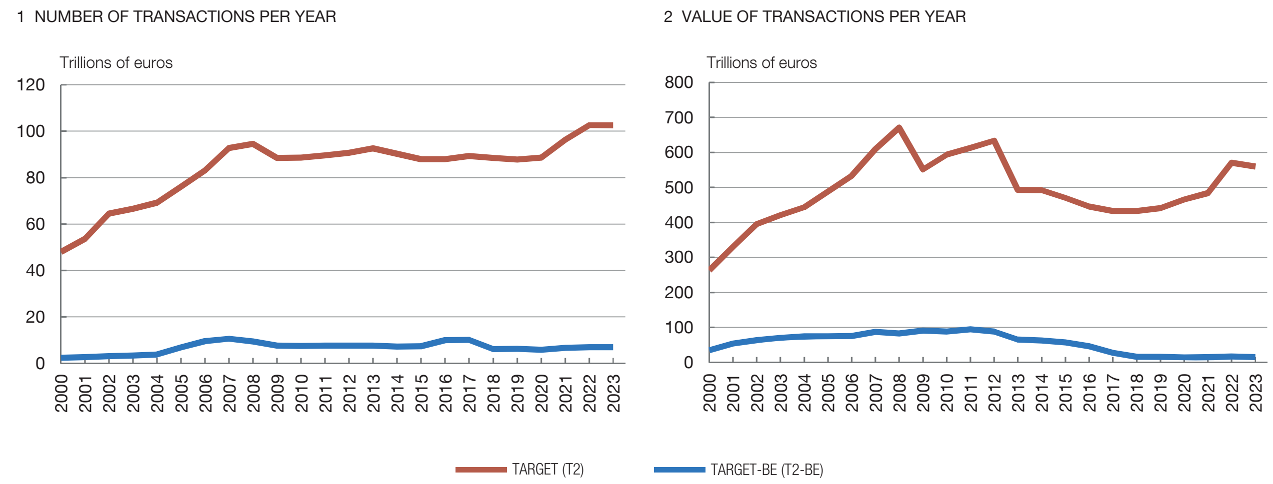
The Banco de España also participates in the cooperative oversight of the other pan-European systemically important payment systems (SIPS). Thus, as regards the systems

1 SEPA stands for Single Euro Payments Area.

2 Regulation (EU) No 795/2014 of the ECB of 3 July 2014 on oversight requirements for systemically important payment systems.

Chart 5.1
OVERVIEW OF TARGET AND TARGET-BE OPERATIONS

In 2023 the Spanish component, TARGET-BE, represented slightly more than 6% of the number of transactions processed in T2 and around 4% of the total value of the transactions.



SOURCE: Banco de España.
NOTE: Data for 2023 are provisional, pending a methodological review following the T2-T2S consolidation project.

operated by EBA Clearing, the main oversight activities were focused on the assessment of system changes and planned new services, in particular: i) the monitoring of the new fraud pattern and anomaly detection (FPAD) functionality for STEP2-T and RT1, the launch of which was scheduled for March 2024; ii) the monitoring of the migration from EURO1 to ISO 20022, which took place in August 2023; iii) the monitoring of the new Immediate Cross-Border Payments (IXB) project, the launch of which is scheduled for the end of 2024; and iv) the monitoring of outstanding recommendations from previous evaluations and incidents. In addition, the periodic comprehensive assessment exercise of STEP2-T and EURO1 was launched in mid-2023. As regards Mastercard Europe as SIPS operator, the first comprehensive assessment of the Mastercard Clearing Management System (MCMS) was completed, and progress was made on the action plan for the implementation of the various recommendations issued.

5.1.2 Retail payment systems in Spain

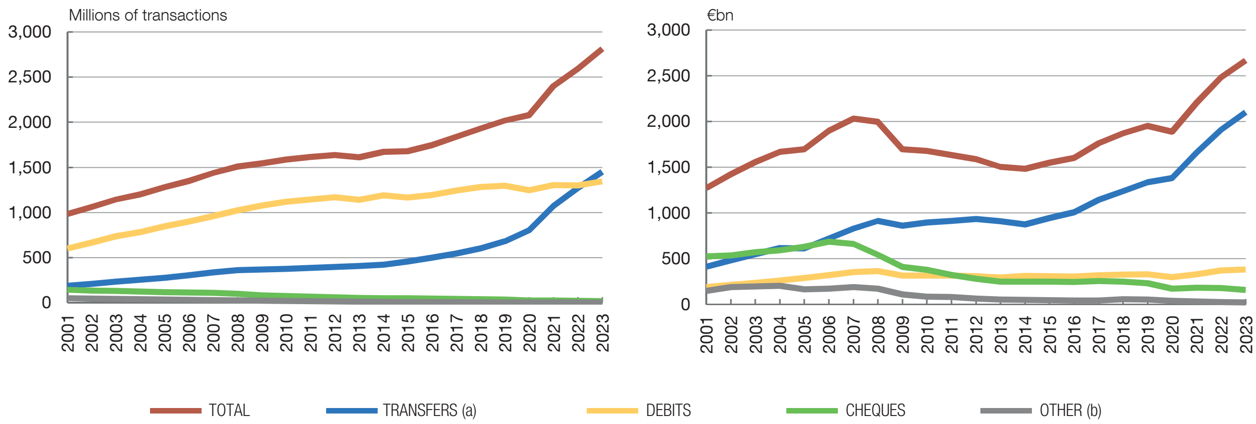
At the national level, the Banco de España is responsible for the oversight of the National Electronic Clearing System (SNCE), the national clearing house managed by Sociedad Española de Sistemas de Pago, SA (Iberpay). Chart 5.2 shows the evolution of the various SNCE subsystems in 2023, in terms of both number of transactions and value. As the Chart shows, SNCE transactions in 2023 maintained the same dynamic as in 2022, with an annual increase of 8.6% in the total number of transactions. This increase is due mainly to instant credit transfers, which grew by 23.6% in 2023, thanks to Bizum transactions and the downward

Chart 5.2
OVERVIEW OF SNCE OPERATIONS

SNCE operations in 2023 maintained the dynamic that was seen in 2022, with an increase of 8.6% in the total number of transactions and 7.4% in terms of value in 2023, led by the growth in transfers.

1 NUMBER OF TRANSACTIONS PER YEAR

2 VALUE OF TRANSACTIONS PER YEAR



SOURCE: Banco de España.

a Including instant transfers as from 2018.
b Including bills of exchange and other.

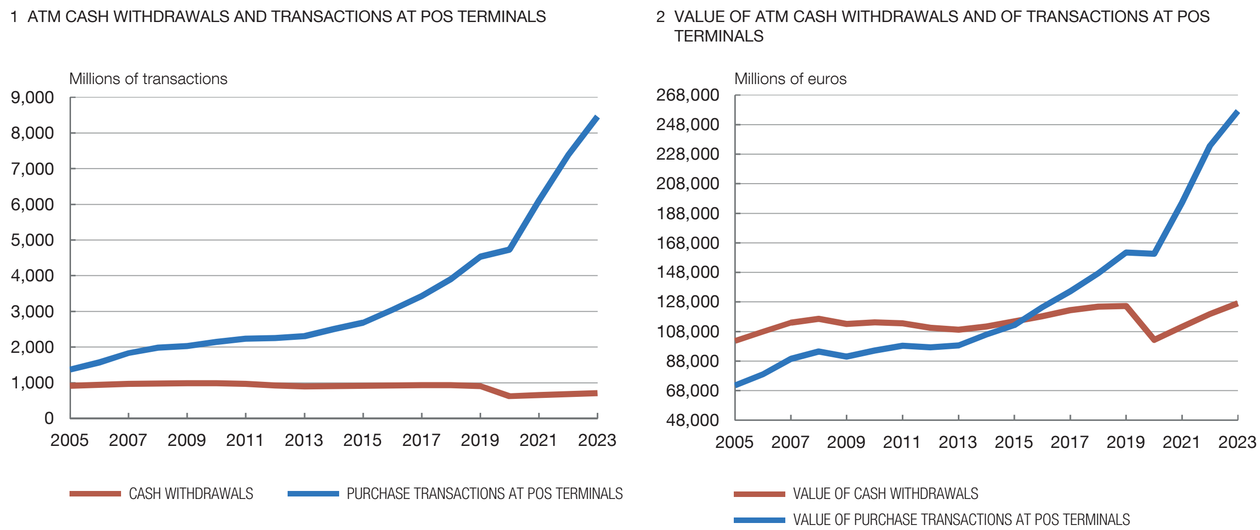
trend in cash transactions, and to a lesser extent to a substitution effect of ordinary credit transfers, which grew by 5.8% in 2023. In contrast, the decline in cheque transactions continued, falling by 12.0%, while direct debits grew by 3.6% in terms of the number of transactions exchanged on the SNCE in 2023. In terms of value, the various SNCE sub-systems did not show significant deviations from the trends described above.

With regard to SNCE oversight activities, Iberpay's annual risk monitoring report was analysed, and it was concluded that Iberpay's risk management model meets the objective of having management policies, procedures and systems in place to identify, measure, oversee and manage the diversity of risks faced by the infrastructure.

The Banco de España is also responsible for the oversight of Sistema de Tarjetas y Medios de Pago, SA (STMP) and monitors its operations. STMP was identified in 2023 as a prominently important retail payment system operator. STMP is responsible for the clearing of a large part of card transactions in Spain and for the interbank settlement of the resulting net multilateral positions. The institutions participating in STMP are payment service providers acting as acquirers and/or issuers of cards under various brands and schemes. The technical processors, Redsys and Cecabank, and the settlement banks are critical service providers for STMP. A comprehensive assessment of STMP was initiated in 2023 under the Eurosystem oversight framework for payment systems. In addition, the technical processors are monitored directly by the Banco de España, given their importance in the Spanish payment ecosystem, and an assessment is under way on the operational incidents that occurred in one of them in November 2023.

Chart 5.3
OVERVIEW OF OPERATIONS WITH CARDS

The disparity in growth of card payments and cash withdrawals continued in 2023 in terms of both volume and value.



SOURCE: Banco de España, based on Sistema de Tarjetas y Medios de Pago data.
NOTE: The levels for 2023 were estimated on the basis of the variable's behaviour in the first three quarters of the year.

Chart 5.3 shows recent developments in STMP-cleared transactions, which account for the bulk of purchases and cash withdrawals with cards at the national level. Moreover, the Chart shows high levels of activity, and the clear difference between the growth in the number of card purchases (14%) and in cash withdrawals (close to 4%) is again confirmed in 2023. In value terms, a similar trend was observed, with growth of 10% in purchases in 2023 and 6% in cash withdrawals.

5.1.3 Payment instruments

The Eurosystem oversight framework for electronic payment instruments, schemes and arrangements (PISA framework) entered into force on 15 November 2022. The PISA framework bases its oversight expectations on the CPMI-IOSCO[3] principles for financial market infrastructures. The Eurosystem regularly conducts a comprehensive exercise to determine the set of payment schemes and arrangements that should be subject to oversight; the list was updated on 2 August 2023.[4] As well as identifying the payment schemes and arrangements, it details the central bank(s) acting as lead overseer(s) and their geographical scope (national or pan-European). The updated PISA list includes, for the first time, Apple Pay and Google Pay as payment arrangements subject to oversight.

3 The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO)

4 https://www.ecb.europa.eu/paym/pdf/List_of_payment_schemes_and_arrangements_overseen_under_PISA_framework.pdf

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Based on the PISA framework, the Eurosystem commenced an assessment exercise in November 2022 to verify compliance of payment schemes with security and efficiency expectations. This exercise was extended to 2023. In particular, the Banco de España participated in the assessments of the SEPA payment schemes operated by the European Payments Council (EPC), i.e. the credit transfer (SCT), instant credit transfer (SCT Inst) and direct debit (SDD Core, SDD B2B) schemes. It also participated in the assessment of the scheme operated by Visa Europe. These tasks are carried out in its capacity as member of the joint oversight groups for each of these pan-European schemes, in which the Banco de España participates together with other national central banks of the Eurosystem and the ECB, which is the lead overseer.

With regard to card fraud in the SEPA area, in May 2023 the ECB published the latest report for 2020 and 2021 on its website.[5] Noteworthy among its findings is the fact that in 2021 the level of fraud was the lowest recorded since these statistics were first collected in 2008. Specifically, the fraud rate for the SEPA area in 2021, in terms of transaction value, stood at 0.028%. Remote fraud —over the telephone and in internet purchases— decreased by 12% in 2021, but still accounts for 84% of total fraud in Europe.

At the national level, with respect to domestic transactions cleared by STMP,[6] the fraud ratio with cards issued in Spain was 0.023% in the first half of 2023, in terms of the number of transactions, as compared to 0.025% in 2022. The implementation of strong authentication, in line with the requirements of the payment services directive, has been a clear step forward in the fight against retail payment fraud. This improvement is even more evident when analysing remote fraud in Spain, where the fraud rate was 0.15% in 2020; in the first half of 2023 it was successfully reduced to 0.13%. The improvement is even more pronounced in terms of value, since the fraud rate fell from 0.21% in 2020 to 0.14% in the first half of 2023.

5.2 Supervision of Iberpay

The Banco de España is responsible for the supervision of Iberpay,[7] which is entrusted by law with operating the SNCE. In the exercise of this function, the Bank is empowered to give prior approval to the company’s articles of association and the basic operating rules of the systems and services that Iberpay manages. Also, the technical or operating instructions regulating the operating procedures of these systems and services, together with the basic operating rules on the complementary services, must be communicated to the Banco de España following their adoption, and in this case the non-opposition of the Banco de España is sufficient for their entry into force.

5 https://www.ecb.europa.eu/pub/cardfraud/html/ecb.cardfraudreport202305~5d832d6515.en.html

6 Data referring to domestic transactions with Spanish cards corresponding to the Visa and Mastercard schemes that are processed by Spanish infrastructures.

7 Article 17 of Law 41/1999 of 12 November 1999 on securities payment and settlement systems.

One of the main activities in the supervision of Iberpay in 2023 was the approval of a new SNCE regulation. It entered into force in March 2023 so that the changes arising from the implementation of the Eurosystem's new TARGET system would be incorporated into the system's rules, and in order to align the terminology used with the new TARGET Harmonised Conditions and to introduce the settlement bank[8] concept into the SNCE.

Also, the Banco de España has assessed 11 operating instructions of the SNCE, which the Bank did not oppose. The main changes they introduced are as follows: i) the adaptation of the technical and operating rules of the SNCE subsystems to the new developments introduced by the new SNCE regulation; ii) the incorporation of the responsibilities of the participants in the transfer subsystems in relation to recall requests due to fraud and the updating of their responsibilities in recall requests due to technical error and duplicity; iii) the finalisation of the project involving the replacement of the physical exchange of documents by the exchange of images through the SNCE, and the incorporation into the rules and operations of each subsystem of the specifications and conditions for the processing of the various payment instruments included in the relevant sectoral agreements; and iv) the adaptation of the instant credit transfer subsystem rules to the new version of the EPC's SEPA Instant Credit Transfer Rulebook.

Also, assessments were performed on a total of four amendments to the basic operating rules of three of the services offered by Iberpay, corresponding to the account switching service, the account ownership confirmation service and the Iberpay link with TIPS service, and the Banco de España did not oppose any of them.

5.3 Oversight of securities infrastructures

Under Law 6/2023 of 17 March 2023 on Securities Markets and Investment Services (LMVSI), the CNMV is tasked with the supervision of securities infrastructures in Spain and, jointly with the Banco de España, with ensuring the smooth operation of Spanish securities clearing, settlement and registration systems. The objective of this task is to preserve the stability of the whole financial system.

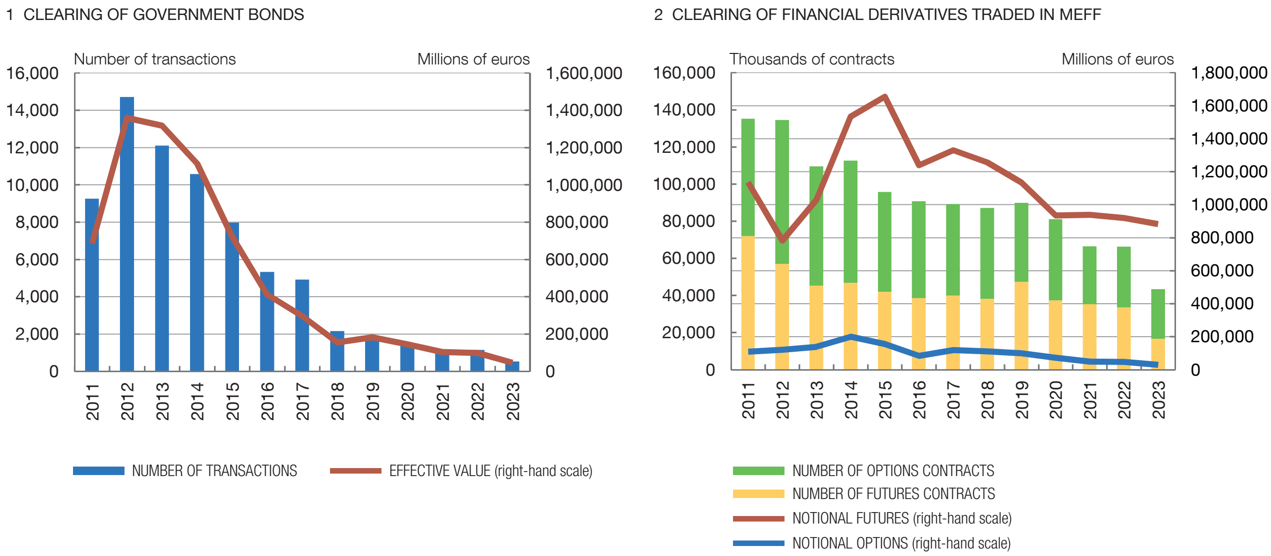
Accordingly, the Banco de España carries out oversight activities on the central securities depository, Iberclear (which operates the ARCO securities settlement system) and the Central Counterparty, BME Clearing (BMEC).

With regard to BMEC's activity, the evolution of the two most significant segments, fixed income and financial derivatives, has followed a downward trend in recent years,

8 Taken to be a credit institution which, without being a member of the SNCE, but being a participant in a TARGET system, has entered into a contractual arrangement with a direct participant in the SNCE whereby the payment obligations arising from the settlement of the direct participant's transactions are paid by debiting the accounts and sub-accounts of the settlement bank in TARGET.

Chart 5.4
OVERVIEW OF BMEC OPERATIONS

The clearing activity in the fixed-income and financial derivatives segment has followed a downward trend in recent years.



SOURCE: BME Clearing.

as shown in Chart 5.4. The clearing activity in the fixed income segment continued to decline, despite the increase in interest rates in 2023. In the financial derivatives segment, both the nominal value and the number of options and futures contracts decreased, in line with this segment's performance in recent years.

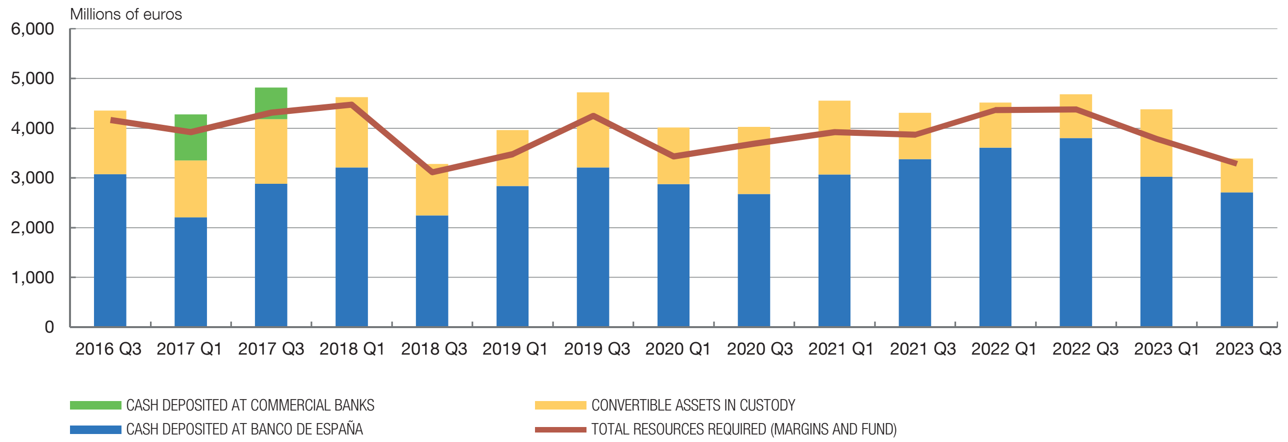
BMEC's financial resources stem mainly from margins and contributions from its clearing members to the guarantee fund. The composition of BMEC's financial resources has remained stable in recent years, and its liquidity is quite high, as can be seen in Chart 5.5. These resources are mainly cash deposited with the Banco de España.

As for Iberclear, the performance of its settlement activity varies depending on the type of instrument (see Chart 5.6). In long-term fixed income securities, there was a slight increase in the value and number of transactions settled in 2023, while in short-term securities there was a slight decrease in value and a sharp increase in the number of transactions. The trend in equities settlement activity remained the same as in recent years, with an increase in terms of value and a decrease in the number of transactions.

In addition, the Banco de España participates in the Eurosystem's cooperative oversight of the T2S platform, which also serves the central securities depositories. In 2023, monitoring continued on the implementation of the recommendations arising from the assessment of the penalty mechanism for delays in the matching and settlement of instructions

Chart 5.5
BMEC. RESOURCES DEPOSITED AND LIQUIDITY

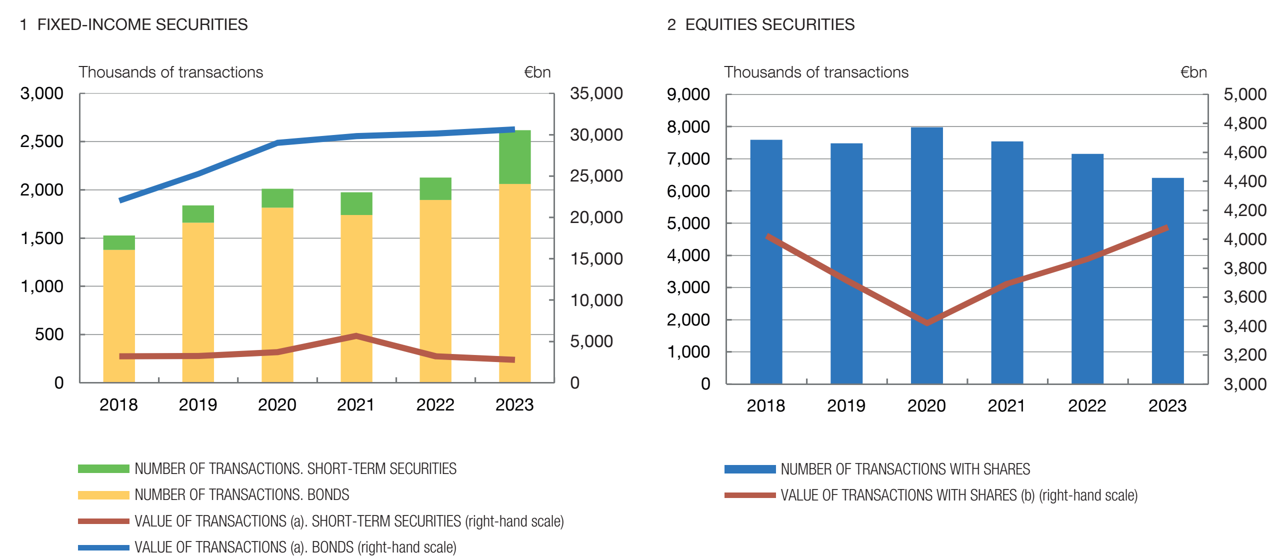
The composition of BMEC's financial resources has remained stable in recent years. Liquidity is quite high and most of it is cash deposited with the Banco de España.



SOURCE: BME Clearing.

Chart 5.6
IBERCLEAR ACTIVITY DATA. TRANSACTIONS PROCESSED

In general, the Iberclear settlement activity maintains the trend of the last few years, with slight growth in value of long-term fixed-income securities settled and stronger growth in the case of equities.



SOURCE: Iberclear.

a Nominal balances.
b Cash settled.

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required by the CSDR Regulation.[9] As a result, it was concluded that most of the recommendations had already been implemented.

5.3.1 Activities resulting from national legislation

As regards BME Clearing, SAU, the Banco de España has issued six mandatory reports in accordance with Articles 86.4 and 94 of the securities markets and investment services law (LMVSI). Specifically, the reports based on Article 86.4 of the LMVSI have dealt with: i) the amendment of BME Clearing's internal rules in order to comply with the provisions of Article 9.14 of Regulation (EU) 2021/23 on a framework for the recovery and resolution of central counterparties (hereinafter, the R&R Regulation); ii) the amendments introduced in the general conditions of the fixed income segment for clearing repo transactions of supranational debt issued by the European Commission; and iii) the amendments to its internal rules so as to implement the new segment on digital asset derivatives and to bring these rules into line with the R&R Regulation in relation to the authorisation of the recovery plan. The reports related to Article 94 referred to the signature of several agreements with other platforms, to service the energy derivatives segment. All the reports were favourable.

5.3.2 Activities resulting from European legislation

In addition to its role as overseer, the Banco de España is a relevant authority in the framework of the CSDR Regulation on behalf of the Eurosystem, acting as the central bank of issue for the euro and the central bank in which the cash leg of a securities settlement system operated by a CSD is settled.

As the relevant authority, the Banco de España participated in the annual review and evaluation of Iberclear for 2022 in accordance with CSDR, in which it continued to assess the integration process between BME and SIX, and where the links with SIX-SIS and NBB-SSS were assessed as well. On the basis of the information provided by Iberclear, the Banco de España has carried out an assessment of Iberclear's operational risks,[10] of the link it has established with the Belgian central securities depository NBB-SSS and of the activity through the links it maintains with other foreign central securities depositories. Activity relating to the links with other central securities depositories has increased, both when it acts as the investor central securities depository and when it is the issuer central securities depository.

As the Eurosystem's representative in the college of supervisors of BME Clearing, in its capacity as the central bank of issue of the currency in which it settles its transactions,

9 Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the EU and central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

10 Article 45.6 of CSDR.

the Banco de España analyses the impact that changes in the central counterparty may have on the clearing and settlement processes, the agreements established for this purpose, the liquidity risk management framework and the interdependencies with other market infrastructures. During 2023, BME Clearing requested authorisation to start clearing derivatives on indices whose underlying assets are digital assets and exchange traded funds. BME Clearing also submitted its recovery plan in 2023, in accordance with the requirements set out in the R&R Regulation. In both cases, the Eurosystem's opinion was positive.

Box 5.1
REGULATION ON INSTANT CREDIT TRANSFERS

On 26 October 2022 the European Commission presented a legislative proposal on instant credit transfers in euro in Europe, amending Regulation (EU) 260/2012 and Regulation (EU) 2021/1230, given their low level of implementation. At the time of the impact analysis carried out by the Commission prior to the publication of the proposal, instant credit transfers accounted for only 11% of total euro credit transfers sent in the European Union (EU).

The figures have improved since the initial analysis was performed, but still fall short of the desired rollout. In particular, in Spain, one of the countries with the highest penetration of instant credit transfers, levels already exceeded 52% of total credit transfers in the second quarter of 2023. In the EU, the figure is considerably lower at 15.46% in the same period.

On 7 February 2024, the European Parliament approved the regulatory text, the main features of which are as follows:

1 Concept of instant credit transfer: credit transfer which is executed immediately, 24 hours a day, on any calendar day. In particular, it provides for the funds to be made available to the payee within ten seconds of receipt of the payment order by the payer's payment service provider.

2 Mandatory provision of the instant credit transfer service: payment service providers have to offer instant credit transfers if they offer ordinary credit transfers. Payment institutions and electronic money institutions will have a longer period to comply with the obligation, in order for an amendment to Finality Directive 98/26/EC to enter into force which will allow them access to designated payment systems.

3 Charges: the charges applied to payment service users for sending and receiving instant credit transfers may not exceed the fees charged for ordinary credit transfers.

4 Verification of the payee identity service: the payer's payment service provider shall provide a service (prior to sending the instant credit transfer and at no cost to the customer) to verify that the name of the payee matches the name of the IBAN holder.

5 Verification of the list of sanctioned persons (targeted financial restrictive measures): the obligation to verify for each transaction that the payment service user is not on any of the lists resulting from the European Union's restrictive measures disappears; it becomes an obligation to comply at least once a day.

Box 5.2
REVIEW OF THE REGULATION ON CENTRAL SECURITIES DEPOSITORIES: SETTLEMENT DISCIPLINE

Background

Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union (EU) and central securities depositories entered into force in 2014.

This Regulation establishes, inter alia, certain requirements related to the settlement cycle and settlement discipline, as well as common requirements for central securities depositories. In particular, it establishes that the intended settlement date shall be no later than the second business day after trade (T+2) for trades in transferable securities executed on trading venues. It also includes rules on settlement discipline, to prevent and remedy securities settlement fails related to: i) reporting requirements; ii) the cash penalties regime; and iii) the mandatory buy-in regime. The reporting requirements and cash penalties entered into force on 1 February 2022. With regard to mandatory buy-ins, it was decided to postpone the entry into force until November 2025, in the expectation that the review under way of the Regulation establishes a new framework.

Review of the Regulation (CSDR Refit)

On 27 December 2023, Regulation (EU) No 2023/2845 amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories and amending Regulation (EU) No 236/2012 was published in the Official Journal of the European Union on 27 December 2023. The main new developments are:

With regard to the settlement cycle: it includes a mandate for the European Securities and Markets Authority to carry out an assessment regarding the potential shortening of the settlement cycle in the EU.

With regard to settlement discipline:

— The scope of the cash penalties and mandatory buy-in regimes is reduced. They will not apply to transactions that fail for reasons that are not attributable to the participants or to transactions that do not involve two trading parties (such as certain primary market transactions, corporate transactions, reorganisations or the creation and redemption of investment fund units). They will also not apply if the failing participant is a central counterparty or in transactions in which insolvency proceedings are opened against the failing participant.

— Cash penalties. The Commission will review the parameters used to calculate the cash penalties in order to eliminate any adverse incentives to fail that could arise in a low or negative interest rate environment.

— Mandatory buy-in regime:

i) In addition to the exclusions mentioned above, the buy-in regime will not apply to securities financing transactions or to transactions already governed by Article 15 of Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps.

ii) The European Commission may introduce this scheme as a measure of last resort provided that these two conditions are met: the current measures do not result in a long-term sustainable reduction of settlement fails or the maintenance of a reduced level of settlement fails, and the level of settlement fails may have a negative effect on the financial stability of the Union.

iii) A pass-on mechanism should be implemented, so that each participant involved in the transaction chain can pass on a buy-in obligation to the next participant. This measure is intended to avoid duplication of costs and certain negative effects on the liquidity of a financial instrument if several buy-ins are applied within a chain.

6

EXERCISE OF SANCTIONING POWERS

EXERCISE OF SANCTIONING POWERS

COROLLARY OF SUPERVISION

Sanctioning powers are closely linked to supervisory powers and are exercised as a supplement to those powers

PUBLICATION OF PENALTIES BY THE BANCO DE ESPAÑA

Except in exceptional cases, penalties imposed for serious and very serious infringements are published on the Banco de España's website

PRUDENTIAL AREA

The area in which the largest number of sanctioning proceedings are concentrated. In 2023, nine such proceedings (of which six were resolved) were conducted against the corresponding institutions and their directors and executives

TRANSPARENCY AND CUSTOMER PROTECTION

In 2023 two proceedings against an electronic money institution (and its directors and executives) and a bank were resolved

EXERCISE OF SANCTIONING POWERS

Sanctioning powers are closely linked to supervisory powers and, therefore, they are exercised as a necessary supplement to them. Thus, in the sanctioning area, a distinction can also be made between proceedings in the prudential area and in the transparency and customer protection area.

In the prudential area, nine proceedings were conducted, all of them against the corresponding entities and their respective directors and executives (proceedings were conducted against a total of 54 natural persons). Of these nine proceedings, six were resolved in 2023.

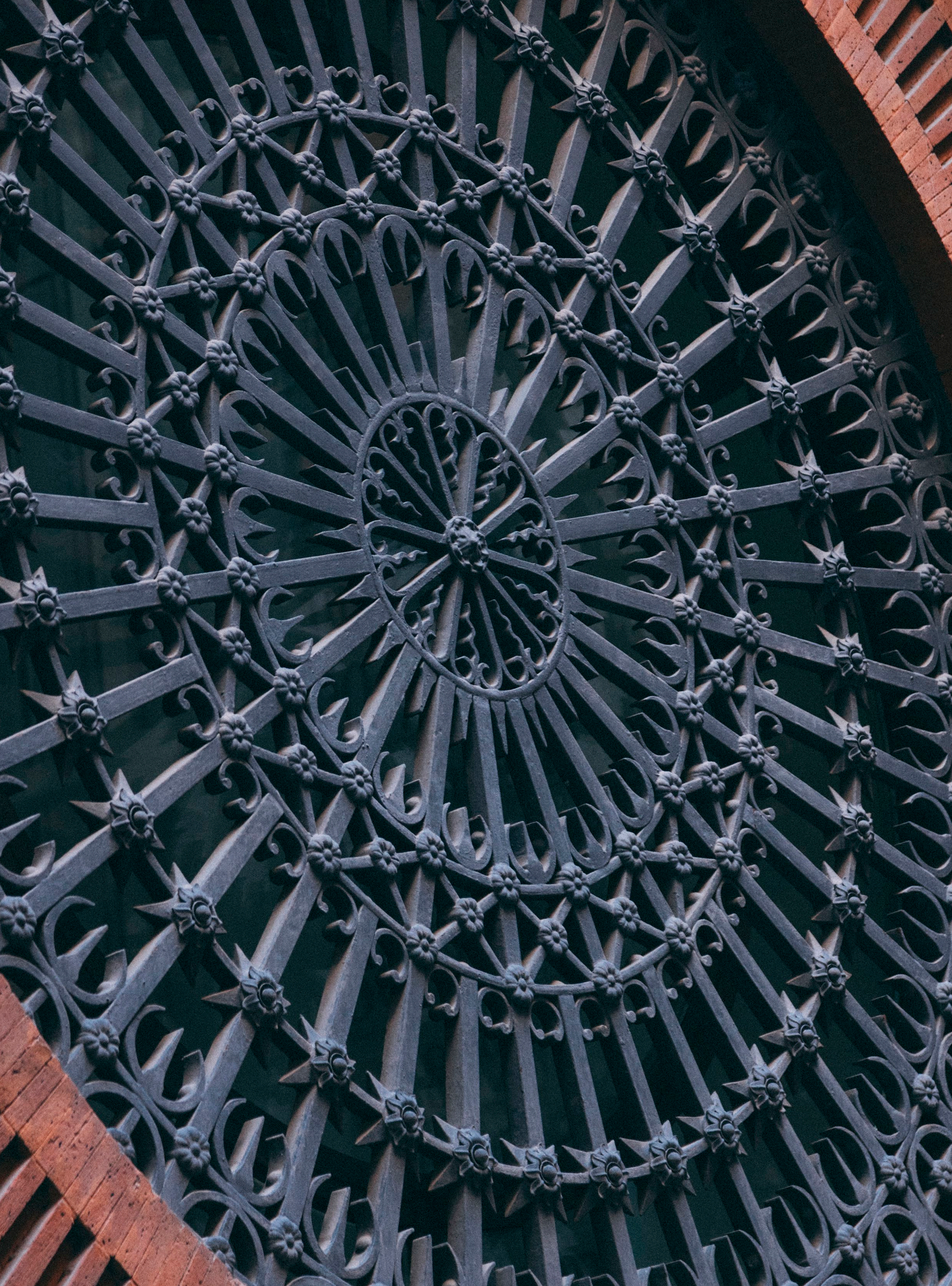
In this same area, the focus was on institutions' internal control, risk management and governance —paying particular attention to the effectiveness of the second and third lines of defence— and, of course, on maintaining sufficient capital to be able to deal with the risks assumed and possible shocks. Accordingly, four proceedings of this nature were being processed in 2023, three of which were resolved that year. These three proceedings were conducted against a specialised lending institution, a credit cooperative and an electronic money institution (ELMI), respectively, and against the directors and executives of these institutions. The remaining proceeding, not resolved in 2023, was initiated at the end of the year against another credit cooperative and its respective directors and executives.

Moreover, appraisal companies and their respective directors continue to be a supervisory priority, which is why it is worth noting two proceedings, both of which were resolved in 2023, due to conduct relating to their organization, procedures and internal control mechanisms.

Lastly, proceedings have been conducted in areas relating to compliance with the rules on the acquisition of qualifying holdings (a proceeding was initiated against an ELMI and some of its shareholders, which was resolved in 2023) and to intrusion. The latter group includes two proceedings, both of which are under way. The first, initiated against a company and its sole director, not only for using names reserved for credit institutions, but also for its refusal to provide information to the Banco de España's inspection services. And the second proceeding, against a company and its sole director, for allegedly engaging in the purchase of foreign currency without the required authorisation to do so.

The Banco de España also focuses on compliance with transparency and bank customer protection rules. In the exercise of these powers, two proceedings were resolved against a bank and an ELMI and the directors and executives of the latter, respectively (one of the above-mentioned proceedings in the prudential area was also initiated against this ELMI). The non-compliance that was the subject of these proceedings concerned, inter alia, shortcomings in relation to the offer and marketing of credit cards, the accrual of interest, the settlement and charging of interest and fees, as well as the delivery and content of pre-contractual and contractual information.

For more information on the penalties imposed, please click on the link below (publication within 15 days from the date on which the penalty becomes final in administrative proceedings): https://www.bde.es/bde/es/areas/supervision/sancion/sanciones-impues/.



7

THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

INTERNATIONAL BODIES

Participating in international banking regulation and supervision fora is a strategic priority for the Banco de España

FINANCIAL STABILITY BOARD

The FSB worked on: i) resolution; ii) strengthening the non-bank financial intermediation sector; iii) analysing and monitoring vulnerabilities associated with digitalisation and climate change, and iv) improving cross-border payments

BASEL COMMITTEE ON BANKING SUPERVISION

Progress was made, inter alia, on Pillar 3, the digitalisation of finance and the review of the Core Principles for Effective Banking Supervision. In addition, the full, consistent and timely implementation of the Basel III reforms continued to be promoted and a report assessing the March 2023 banking turmoil from a supervisory and regulatory standpoint was published

EUROPEAN BANKING AUTHORITY

The EBA's priorities included: i) finalising implementation of Basel III in the EU; ii) running an enhanced EU-wide stress test; iii) putting its data infrastructure at the service of stakeholders; iv) delivering on the DORA and MiCA mandates; v) enhancing the capacity to fight ML/FT in the EU, and vi) executing the ESG roadmap

EUROPEAN SYSTEMIC RISK BOARD

Among other issues, the ESRB worked on a cyber risk mitigation strategy, analysed the financial stability implications of developments in crypto-assets and decentralised finance, issued a report on vulnerabilities in the residential real estate sector, and prepared adverse scenarios for the climate risk analysis exercise

OTHER

The Banco de España actively participated in FinCoNet, the Committee on Payments and Market Infrastructures and the Network of Central Banks and Supervisors for Greening the Financial System on climate change

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THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

Participating in international banking regulation and supervision fora is one of the Banco de España's strategic priorities, and one of its objectives is to have a greater say in these fora. The main international banking regulation and supervision fora in which the Banco de España participates are presented in Figure 7.1.

Figure 7.1
THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION FORA

GLOBAL FORA	EUROPEAN FORA	OTHER FORA
- Financial Stability Board (FSB)	- European Banking Authority (EBA)	- International Financial Consumer Protection Organisation (FinCoNet)
- Basel Committee on Banking Supervision (BCBS)	- European Systemic Risk Board (ESRB)	- Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements (BIS)
		- Network for Greening the Financial System (NGFS)

SOURCE: Banco de España.

7.1 Global fora

7.1.1 Financial Stability Board

The Financial Stability Board (FSB) is responsible for promoting international financial stability and, to this end, it coordinates national financial authorities and international standard-setting bodies. The turmoil of early 2023 marked the most significant stress episode for the banking sector since the financial crisis of 2008. Accordingly, the FSB published a report outlining the lessons learnt for the international resolution framework.

In addition, the FSB continued to monitor the risks associated with the non-bank financial intermediation (NBFI) sector and published its annual progress report, describing the work carried out to strengthen this sector, which includes: i) a consultation on the revised recommendations to address vulnerabilities from the liquidity mismatch in open-ended funds; ii) measures to enhance margining practices, including recommendations relating to the liquidity of non-bank market participants; iii) analysis of the implementation by FSB members of the proposals published in 2021 to strengthen money market funds; an assessment of the functioning and resilience of commercial paper and certificates of deposit, and v) the publication of a report on the financial stability implications of leverage in the NBFI sector.

The FSB continued to analyse vulnerabilities associated with other structural changes, particularly those relating to financial innovation and climate change. The FSB updated its Cyber Lexicon and published recommendations for regulators and supervisors to achieve greater convergence in cyber incident reporting. Moreover, it is developing a common format for cyber incident reporting at international level. In response to the risks related to outsourcing, the FSB published a discussion paper with a toolkit to help financial institutions, supervisors and regulators identify critical services and comprehensively manage these risks. Regarding crypto-assets, the FSB completed the regulatory framework for crypto-asset activities, based on the principle of “same activity, same risk, same regulation”, which provides a strong basis for ensuring that crypto-asset activities and stablecoins are subject to consistent and comprehensive regulation, commensurate to the risks they pose, while continuing to support innovation. The FSB also collaborated with the International Monetary Fund (IMF) on the publication of a joint paper on crypto-assets that distils the FSB's perspective on financial stability, and the IMF’s macro-financial view. In addressing financial risks stemming from climate change, the FSB published its annual progress report on its roadmap and the monitoring report on climate-related financial risk disclosures. The FSB also examined the inclusion of climate-related risk factors in compensation frameworks.

Over the course of 2023, it continued to work on central counterparty (CCP) resolution and established a framework with resources and tools that should be made available to the resolution authorities.

Lastly, the FSB remains focused on enhancing cross-border payments, in order to make them faster, cheaper, more transparent and more inclusive. In 2023, the roadmap moved into a practical phase with the publication of a list of priority actions: payment system interoperability and extension, legal, regulatory and supervisory frameworks, and cross-border data exchange and message standards.

7.1.2 Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (BCBS), which was chaired by the Governor of the Banco de España until June 2024, is the international body responsible for setting global standards for the prudential regulation of internationally active banks, while acting as a forum for cooperation on banking supervision matters.

The BCBS published a report on the events of March 2023, providing an assessment of the causes of the banking turmoil and the regulatory and supervisory responses. The report also outlines the lessons learnt and takeaways for supervision and regulation. In this respect, the Committee will undertake follow-up initiatives, prioritising work to strengthen supervisory effectiveness and identifying issues that may warrant additional guidance at a global level. Furthermore, it will carry out analytical work based on empirical evidence to evaluate whether specific features of the Basel framework were fit for purpose during the March 2023 turmoil and, if necessary, assess the need to explore regulatory policy options over the medium term.

In relation to financial digitalisation, the BCBS published a discussion paper on the supervisory and financial stability implications of digital fraud. The BCBS continues to work on the implications of digitalisation for the banking system and supervision, focusing on technological developments. This includes considerations relating to the emergence of new operators and providers, the use of artificial intelligence and other innovations. Following the 2022 report on the prudential treatment of banks' exposures to crypto-assets, the BCBS issued a consultative document in December 2023 on specific amendments to the framework and a proposal on disclosure requirements (see Box 7.1). Additionally, the BCBS continues to monitor developments in this area, in particular, the role of banks as issuers of stablecoins and tokenised deposits, safekeeping activities and other potential interconnections.

In 2023, the BCBS continued its efforts to address financial risks arising from climate change from a regulatory, supervisory and disclosure perspective. As regards Pillar 3, it published a consultative document on the disclosure of climate-related financial risks (see Box 7.1).

As recommended by the Group of Central Bank Governors and Heads of Supervision, the Committee's work on monitoring and reviewing the standards currently in place was limited to a set of specific initiatives. A public consultation on the review of the Core Principles for Effective Banking Supervision was issued in 2023. The work of the BCBS also includes analysing banks' interconnections with the NBFI sector and developing updated supervisory principles on banks' outsourcing practices.

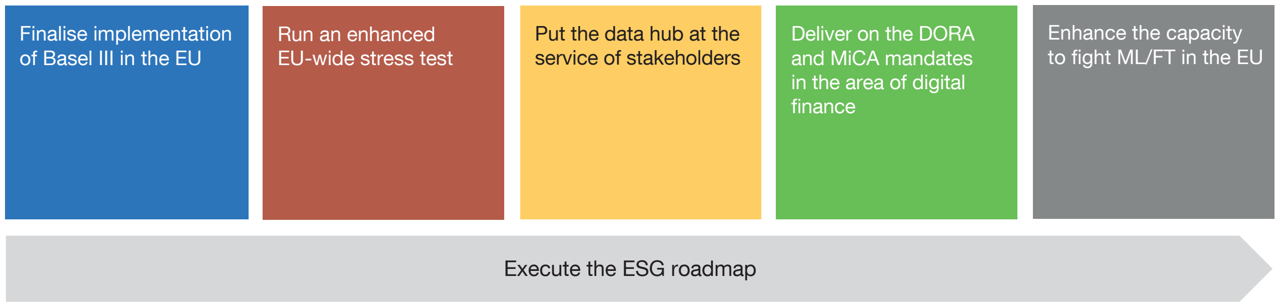
Regarding the implementation and evaluation of the reforms, the BCBS continued to promote the full and consistent application of Basel III and monitored its status across member jurisdictions through the Regulatory Consistency Assessment Programme. It also published a report on the implementation of the principles for risk data aggregation, which provides an update on the progress made by 31 global systemically important banks, ten years after the principles were published.

7.2 European fora

7.2.1 European Banking Authority

The European Banking Authority (EBA) is an independent European Union (EU) authority that plays a key role in safeguarding the integrity and robustness of the EU banking sector to support financial stability. The Banco de España is represented on the

Figure 7.2
THE EBA'S STRATEGIC PRIORITIES IN 2023



SOURCE: EBA.

Board of Supervisors and the Management Board by the Director-General Financial Stability, Regulation and Resolution.

In 2023, its work was structured around five vertical strategic priorities and one horizontal priority (see Figure 7.2). However, its work programme was disrupted by unforeseen events. As a result of the March banking turmoil and the high interest rate environment, the EBA spent much of its time assessing the risks faced by the EU banking sector. Thus, in July 2023, it published the findings of an analysis of unrealised losses on European banks' bond holdings, which concluded that these losses had been contained.

In the area of regulation and prudential supervision, the EBA prioritised the implementation of Basel III. In 2023, it began work on the mandates provided for in the amendments to Regulation (EU) No 575/2013 (CRR-III) and Directive 2013/36 (CRD-VI) focusing on market risk, credit risk, operational risk, supervisory reporting and Pillar 3. In addition, it performed other key tasks, such as monitoring the implementation of the regulatory package on interest rate risk in the banking book (IRRBB)[1] published a year earlier.

It also continued working to ensure transparent and effective banking supervision in the EU. In 2023**,** the EBA continued to conduct peer reviews of the supervisory activities of competent authorities.[2] In October, the three European Supervisory Authorities (ESAs) – the EBA, the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) – published a framework for supervisory independence[3] based on four key principles: operational independence, financial independence, personal independence and transparency and accountability. Despite its non-binding nature, this framework will serve as a benchmark for the ESAs to assess the degree of independence of supervisory authorities in Europe.

1 See the EBA's statement on the monitoring of the IRRBB framework (EBA/REP/2024/02).
2 https://www.eba.europa.eu/supervisory-convergence/peer-reviews.
3 See the joint European Supervisory Authorities' criteria on the independence of supervisory authorities (JC 2023 17).

Lastly, in the area of resolution, in addition to monitoring the level of equity and eligible liabilities, the EBA approved Guidelines on resolvability testing in 2023. These Guidelines are part of a trilogy[4] of EBA Guidelines aimed at verifying the preparedness of resolution authorities and institutions for the resolution process and ensuring the effectiveness of the planned strategy.

In July 2023, addressing its second priority, the EBA published the results of the stress testing conducted on a total of 70 banks in 16 European countries. This stress test exercise included a number of improvements such as an increased sample or, for the first time, the introduction of top-down elements in the analysis (see Chapter 2, section 2.4.3).

In relation to its third priority, the EBA continued to work on building an EU-wide data infrastructure that will enhance both its analytical capabilities and the information available to stakeholders. In 2023, it launched the Pillar 3 Data Hub,[5] a strategic project for enhancing transparency and centralising the Pillar 3 disclosures of all European credit institutions. Moreover, in collaboration with the European Central Bank (ECB), the EBA is developing an integrated system for statistical, prudential and resolution reporting that will make reporting processes more efficient and less costly.

Efforts in the digital finance and financial innovation area focused on the legislative developments deriving from the MiCA and DORA Regulations, which are due for completion in 2024. As far as DORA is concerned, the ESAs have worked on the various regulatory policy mandates (13) received from the co-legislators, as well as on a practical exercise seeking to understand the current landscape of technological providers in the EU.[6] As regards the MiCA Regulation, Figure 7.3 details the numerous technical standards and guidelines open to public consultation in 2023. The EBA has also begun preparing for the structural changes to its supervisory functions ushered in by the two Regulations.[7]

Over 2023, the EBA also contributed to the effective implementation of the EU's AML/CFT framework (its fifth strategic priority). The EBA developed new Guidelines and continued to review the approaches taken by the competent authorities to address these risks. Lastly, it continued to foster cooperation and the exchange of information between the EU's financial services supervisors to strengthen cross-border supervision.

In the area of conduct and the protection of financial services users, the EBA oversaw the first ever mystery shopping exercise[8] conducted by the competent authorities. Aside from

4 These comprise the Resolvability Testing Guidelines (EBA/GL/2023/05), the Resolvability Guidelines (EBA/GL/2022/01) and the Transferability Guidelines (EBA/GL/2022/11).

5 See the discussion paper on the Pillar 3 Data Hub processes and practical implications (EBA/DP/2023/01).

6 See the ESAs Report on the landscape of ICT third-party providers in the EU (ESA 2023 22), which sets out the lessons learned to help the design of the regulatory technical standards (RTS) and the implementing technical standards (ITS) deriving from DORA.

7 Under the DORA and MiCA Regulations, the EBA must contribute to the effective supervision of the providers of ICT services to the financial system, and of the issuers of asset-referenced tokens (ART) and electronic money tokens (EMT).

8 Mystery shopping refers to an investigative approach used by the supervisory authorities to better understand the conduct of financial institutions towards their customers.

Figure 7.3
WORK BY THE EBA ON DEVELOPING THE LEVEL 2 AND 3 MEASURES INCLUDED IN THE MiCA REGULATION

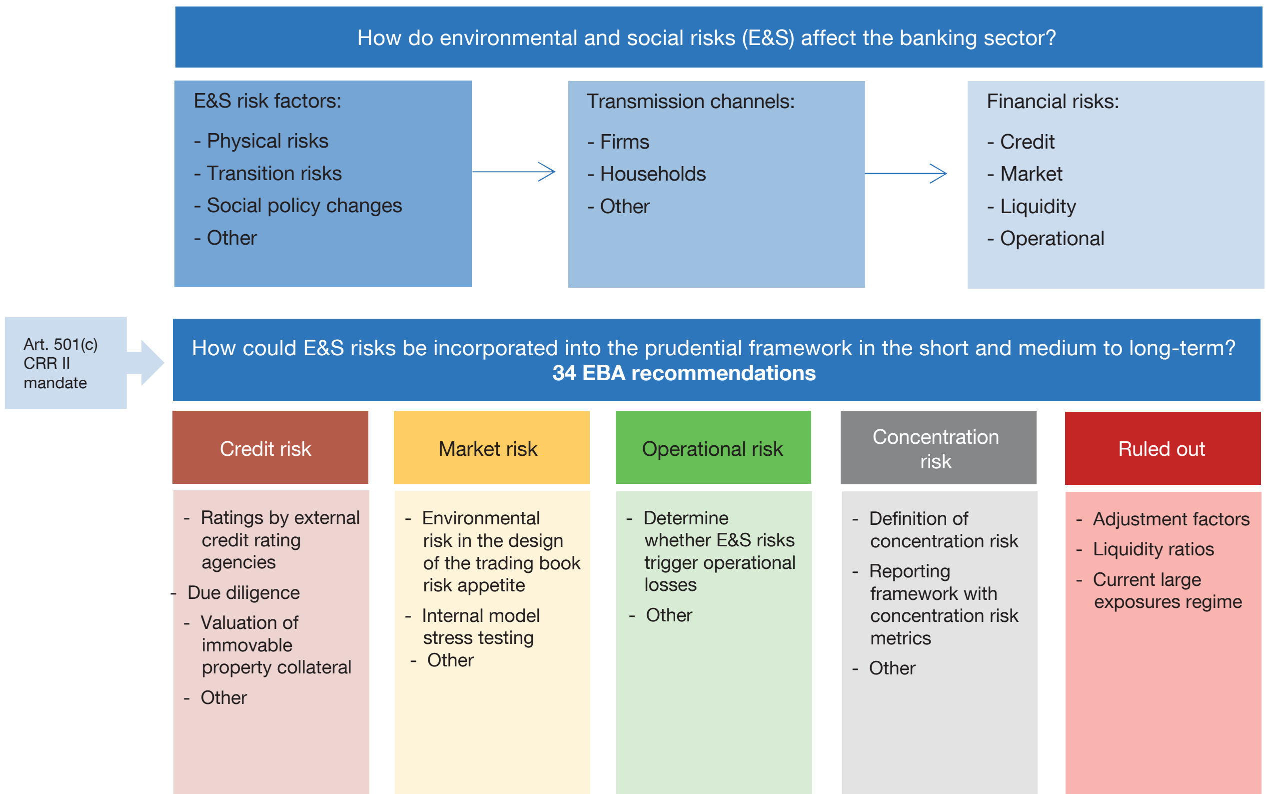
Authorisations	RTS and ITS on information for authorisation as issuers of ARTs RTS on information for assessment of a proposed acquisition of qualifying holdings in issuers of ARTs
Own funds	RTS on the procedure and timeframe to adjust own funds requirements for ‘significant’ issuers. RTS on the adjustment of own funds requirements and design of stress testing programmes for issuers
Governance	EBA-ESMA Guidelines on the suitability assessment of the members of the management body of issuers of ARTs and of CASPs Guidelines on internal governance arrangements for issuers of ARTs RTS on requirements for policies and procedures on conflicts of interest for issuers of asset-referenced tokens (ARTs)
Liquidity	Guidelines on liquidity stress testing RTS specifying the liquidity requirements of the reserve of assets RTS specifying the highly liquid financial instruments in the reserve of assets RTS specifying the minimum contents of the liquidity management policy and procedures
Reporting	ITS on the reporting on ARTs and EMTs denominated in a non-EU currency RTS on the use of ARTs and EMTs denominated in a non-EU currency as a means of exchange
Conduct	RTS on the procedure for the approval of white papers of ARTs issued by credit institutions RTS on complaints handling procedures for issuers of ARTs
Other	RTS on supervisory colleges Guidelines on recovery plans for issuers of ARTs and EMTs
Call for advice	Delegated act on criteria for the classification of ARTs and EMTs as significant Delegated act on the supervisory fees to be charged to issuers of significant ARTs and EMTs

SOURCE: Banco de España.
NOTE: Of all of the mandates attributed to the EBA under the MiCA Regulation, only the consultation paper of guidelines on redemption plans has yet to be published. Also pending is a joint mandate for the three ESAs to develop crypto-asset classification guidellines.

delivering on various mandates, the EBA set in place a work stream to analyse the extent to which the procedures for assessing the solvency of non-bank lenders may contribute to the problem of consumer overindebtedness.

Lastly, it continued using the roadmap set in place in relation to environmental, social and governance (ESG) risks, the EBA's only horizontal priority. Worth noting here is the publication

Figure 7.4
EBA REPORT ON THE ROLE OF ENVIRONMENTAL AND SOCIAL RISKS IN THE PRUDENTIAL FRAMEWORK



SOURCE: Banco de España.

of a report on the inclusion of these risks in Pillar 1.[9] The report sets out specific short-term improvements (see Figure 7.4) to the current standards alongside broader changes to be considered in the medium to long-term, in line with developments at an international level. The EBA also responded to two calls for advice from the European Commission: a progress report on greenwashing[10] and a report on green loans and mortgages.[11] Lastly, in collaboration and coordination with the other ESAs, the ECB and the ESRB, it worked on preparing the climate change stress test that aims to assess the resilience of the financial system in line with the "Fit for 55" package of measures,[12] to be conducted in 2024.

9 EBA report on the role of environmental and social risks in the prudential framework (EBA/REP/2023/34).

10 EBA progress report on greenwashing monitoring and supervision (EBA/REP/2023/16).

11 EBA report on green loans and mortgages (EBA/REP/2023/38).

12 The "Fit for 55" framework refers to the target of reducing greenhouse gas emissions by at least 55% by 2030 with respect to those recorded in 1990. To this end, the co-legislators have approved a package of measures to bring EU legislation into line with the 2030 goal.

7.2.2 European Systemic Risk Board

The European Systemic Risk Board (ESRB), of which the Banco de España is a member institution, is entrusted with the macroprudential oversight of the EU financial system and the prevention and mitigation of systemic risk.[13] The General Board of the ESRB brings together the heads of central banks and authorities with responsibility for banking, securities and insurance regulation and supervision from across the EU. The Banco de España's Governor and Director General Financial Stability, Regulation and Resolution[14] sit on the General Board. The General Board is supported and guided by an Advisory Technical Committee, chaired by the Banco de España's Governor, Pablo Hernández de Cos, since 2019.

The ESRB continuously monitors the risks to financial stability in the EU and assesses the domestic macroprudential policies.[15] In 2023 the ESRB's work took place against a backdrop of systemic risks relating to high inflation and tighter financial conditions (although these did not ultimately materialise, and banks in the EU continued to post healthy profits and NPL ratios). The ESRB centred much of its efforts on financial stability-related issues concerning cyber resilience, financial innovation and developments in the residential real estate market. It also advised the European co-legislators on the technical review of the EU market infrastructure regulations, issuing recommendations on the voluntary reciprocity of the macroprudential policy measures adopted in several countries and designing the macro-financial scenarios for the stress testing conducted by the EBA (on the banking sector) and the ESMA (on central counterparties).

In 2023 the ESRB continued to work on a strategy for mitigating potentially systemic cyber risks. In its report[16] it calls on the EU authorities to make further progress in three areas: i) cyber resilience and stress testing; ii) setting systemic impact tolerance objectives; and iii) financial crisis management tools. The ESRB's work encompasses the financial system as a whole and supplements the activities (targeted at individual institutions) pursued by the three ESAs within the framework of the digital operational resilience regulations.

The ESRB also turned its attention to the financial stability implications of the latest developments in crypto-assets and decentralised finance. The ESRB analysed the initiatives in place in various jurisdictions to address the challenges posed by the rapid growth of crypto-assets and decentralised finance. Various lines of action are proposed in its report,[17] aimed, inter alia, at improving the EU's capacity to monitor the potential channels of contagion, as well as analysing the available options for addressing the risks from crypto-asset conglomerates, leverage using crypto-assets, the new operational challenges and crypto-asset-related services.

13 For an introductory overview of the ESRB's remit and its work to date, see "The first ten years of the European Systemic Risk Board (2011-2021)". *Financial Stability Review* - Banco de España, 42, pp. 119-152.

14 Pablo Hernández de Cos (voting member) and Ángel Estrada (non-voting member), respectively.

15 See the *Annual Report 2022* and *EU Non-bank Financial Intermediation Risk Monitor 2023,* both from July 2023.

16 See *Advancing macroprudential tools for cyber resilience,* report of 14 February 2023.

17 See *Crypto-assets and decentralised finance,* ESRB report of 25 May 2023.

As far as the residential real estate sector is concerned, the ESRB prepared a follow-up report on vulnerabilities in the residential real estate sectors of the European Economic Area (EEA) countries. This report[18] reveals that the level of accumulated risks remains significant in most EEA countries, although Spain is not among them. If the vulnerabilities in this sector were to increase again, the countries that have received recommendations or warnings in the past should continue addressing them with macroprudential policies, alongside other potentially useful measures.

In 2023, the ESRB worked on preparing the adverse scenarios for the "Fit for 55" climate risk analysis. The European Commission tasked the ESAs with conducting this one-off exercise in cooperation with the ECB and the ESRB. The aim is to assess in 2024 the resilience of the EU financial system, as well as its capacity to support the EU's green transition strategy so as to meet the climate targets set for 2030. The various adverse macro-financial scenarios designed by the ESRB for this exercise were based on the methodologies used in the ESAs' stress tests.

7.3 Other fora

In the conduct and consumer protection area, the Banco de España is a member of the Governing Council of the International Financial Consumer Protection Organisation (FinCoNet) and it participates actively in various working groups. These working groups analyse the risks to consumers and the regulatory and supervisory approach to "Buy Now, Pay Later" products, reviewing the framework for conduct supervision and analysing the efficacy of the different supervisory models and conduct supervision in challenging times. Worth noting was the publication in 2023 of the reports on sales incentives in the marketing of mortgage loans; the impact of remote working on supervision after the COVID-19 pandemic and the use of suptech tools in this context; and the supervisory implications of non-traditional financial institutions (such as bigtechs or fintechs) offering financial services, especially payments.

The Banco de España also sits on the Committee on Payments and Market Infrastructures (CPMI)[19] of the Bank for International Settlements (BIS). In 2023 the Banco de España contributed to the CPMI's work on the G20 roadmap for the cross-border payments programme. Here, in collaboration with the FSB, it worked on a series of priorities, such as improving (direct) access to payment systems, extending and aligning the operating hours of the main payment systems and seeking to interconnect or better harmonise such systems. In general, the sector has been encouraged to play a more active role in this area.

18 See *Follow-up report on vulnerabilities in the residential real estate sectors of the EEA countries,* ESRB report of 1 February 2024.

19 The primary function of the CPMI is to promote the safety and efficiency of payment, clearing, settlement and related arrangements, thereby supporting financial stability and the wider economy. Made up of senior officials from 25 central banks, the Committee oversees and analyses such arrangements both within and across the different jurisdictions.

Meanwhile, the Banco de España also took part in projects concerning infrastructure risk management. Notable examples include the creation of a work stream on operational resilience, which, together with the International Organization of Securities Commissions (IOSCO), is revising the CPMI-IOSCO guidance on cybernetic resilience. Given its strategic importance, work continued, in partnership with IOSCO, on analysing the management of CCP risks. Specifically, the way in which CCPs use margin requirements and auctions for default management was analysed, as were the available instruments for hedging losses not deriving from a default on the part of a clearing member.

Also in partnership with IOSCO, in 2023 the CPMI worked on identifying and evaluating potential problems that may emerge with innovations concerning digitalisation in the payments area, focusing on the future of payments in a tokenised financial ecosystem and opening discussions on the technical capacities of central banks in relation to collaboration on cross-border functionalities relating to a central bank digital currency.

The Network for Greening the Financial System (NGFS)[20] continued working to improve the management of the financial risks associated with climate change and the environment. Worth noting in 2023 were the following publications: i) a report on transition plans, which has helped to better understand this new tool;[21] ii) a note on short-term scenarios[22] aimed at making climate scenarios more granular; and iii) a report on the micro-prudential supervision of the litigation risk[23] deriving from climate change-related activity, in which, among other matters, a series of supervision tools for addressing this risk are proposed. The NGFS also made significant strides in analysing nature-related financial risks, such as biodiversity loss, developing a possible conceptual framework.[24]

20 Network of supervisors and central banks from all over the world. At November 2023 it had 129 members and 21 observers. The Banco de España has been a member since April 2018.

21 *Stocktake on Financial Institutions' Transition Plans and their Relevance to Micro-prudential Authorities.*

22 *Conceptual note on short-term climate scenarios.*

23 *Report on micro-prudential supervision of climate-related litigation risks.*

24 *Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors.*

Box 7.1

PROGRESS IN IMPLEMENTING THE BASEL PILLAR 3 FRAMEWORK: CONSULTATIVE DOCUMENTS ON BANKS' EXPOSURES TO CRYPTO-ASSETS AND CLIMATE-RELATED FINANCIAL RISKS

The Basel Committee on Banking Supervision (BCBS) published two consultative documents on disclosures in 2023.

Consultative document on banks' exposures to crypto-assets

In December 2022 the BCBS published the global standard on the prudential treatment of banks' exposures to crypto-assets. Subsequently, in October 2023, the Committee issued for consultation a set of templates and a standardised disclosure table to facilitate the consistency and comparability of banks' disclosures to the market of their crypto-asset exposures.

Specifically, the proposal published by the BCBS includes one qualitative table and three quantitative templates.

— **Qualitative disclosure on a bank's activities related to crypto-assets and the approach used in assessing the classification conditions** (CAEA): includes qualitative information on a bank's activities related to crypto-assets and how these activities translate into components of the bank's risk profile. Information is requested about risk management policies, along with a description of the most significant emerging risks associated with crypto-assets, and a description of the approach used in assessing the classification conditions for Group 1, which includes tokenised traditional assets (Group 1a) and stablecoins with an effective stabilisation mechanism and a regulated and supervised issuer (Group 1b).

— **Crypto-asset exposures and capital requirements** (CAE1): for each type of crypto-asset, a breakdown is requested of credit risk and market risk capital requirements and of the market value of the crypto-assets that the bank holds in custody for clients. Information is also requested about the Group 2 exposure limit (1%-2% Tier 1) and, where the authorities apply to Group 1 crypto-assets the add-on to cover possible operational weakness stemming from the infrastructure used, the banks must disclose the amount of the resulting risk-weighted assets.

— **Accounting classification of exposures to crypto-assets** (CAE2): for each type of crypto-asset, a breakdown of the exposure is requested depending on how the crypto-assets have been classified in the financial statements.

— **Liquidity requirements for exposures to crypto-assets** (CAE3): for each type of crypto-asset a breakdown of its prudential treatment is requested, according to the liquidity standards (LCR and NSFR), distinguishing between when a bank acts as an investor with crypto-asset exposures and when it acts as an issuer with a crypto-liability on its balance sheet.

Once the standard has been finalised, the definitive tables and templates will be incorporated into the Basel disclosure framework.

Consultative document on climate-related financial risks

As part of its holistic approach to address climate-related financial risks, the BCBS published, in November 2023, a consultative document on the disclosure requirements for such risks. The consultative document includes two qualitative tables and five quantitative templates (see Figure 1). In order to incorporate a reasonable level of flexibility into a future framework, the Committee will consider which elements would be mandatory and which subject to national discretion.

The qualitative tables (CRFRA and CRFRB) incorporate aspects on governance, strategy, risk management and concentration risk in relation to climate-related financial risks. Most of these requirements are in line with the standard of the International Sustainability Standards Board (ISSB).

The quantitative templates request information about the following:

— **Exposures by sector and financed emissions** (CRFR1): the Committee's analytical reports highlighted that the economic and financial impacts of transition risks may vary depending on the sector in which an obligor is operating, as certain sectors will have greater sensitivity to the transition to a low-carbon economy. The BCBS proposes that banks disclose exposures to non-financial corporates by sector, using the Global Industry Classification Standard (GICS), as well as information about the credit quality and maturity ladder of these exposures. In addition, information is requested about greenhouse gas (GHG) financed emissions (Scopes 1, 2 and 3).

Box 7.1

PROGRESS IN IMPLEMENTING THE BASEL PILLAR 3 FRAMEWORK: CONSULTATIVE DOCUMENTS ON BANKS' EXPOSURES TO CRYPTO-ASSETS AND CLIMATE-RELATED FINANCIAL RISKS (cont'd)

Figure 1
CONSULTATIVE DOCUMENT ON CLIMATE-RELATED FINANCIAL RISKS

	Qualitative tables		Quantitative tables				
	CRFRA	CRFRB	CRFR1	CRFR2	CRFR3	CRFR4	CRFR5
	Governance, strategy and risk management	Physical, transition and concentration risk	Exposures and financed emissions by sector	Exposures subject to physical risk	Energy efficiency of exposures collateralised by immovable property	Emission intensity per physical output	Facilitated emissions
Scope of application	To be determined following consultation	To be determined following consultation	To be determined following consultation	To be determined following consultation	Subject to national discretion	Subject to national discretion	Subject to national discretion
Type of risk	Physical risk	Physical risk		Physical risk			
	Transition risk	Transition risk	Transition risk		Transition risk	Transition risk	Transition risk

SOURCE: Banco de España.

— **Exposures subject to physical risk** (CRFR2): the Committee requests disclosure of exposures to non-financial corporates and exposures collateralised by immovable property subject to physical risk by geographical area. The aim is for users of Pillar 3 disclosures to better understand a bank's risk profile based on the geographical split of its exposures.

— **Real estate exposures in the mortgage portfolio by energy efficiency level** (CRFR3): loans secured by immovable property are subject to transition risk insofar as jurisdictions implement legislation to reduce real estate emissions. The BCBS proposes that these exposures be disclosed by energy efficiency levels (for example, in kWh/m²).

— **Emission intensity per physical output** (CRFR4): physical activity emission intensity metrics could provide users of Pillar 3 disclosures with useful and comparable information about emission intensity, as opposed to only considering absolute emissions. The Committee therefore proposes a template for banks to disclose their emission intensity metrics and their emission reduction targets. The chosen metrics must be relevant to the disclosed sector (for example, tonnes of CO2 per passenger distance in the transportation sector).

— **Facilitated emissions** (CRFR5): facilitated emissions refer to those attributed to a bank providing capital markets and financial advisory services (for example, equity underwriting, securitisation, etc.) to a counterparty. The Committee requests the disclosure of emissions linked to these activities which generally generate fees, do not provide direct financing and are material for investment banks.

In short, the proposed framework is a first step towards harmonising Pillar 3 requirements for the disclosure of climate-related risks for internationally active banks. The BCBS recognises that jurisdictions' varying degree of preparedness and the need to evolve in terms of data and methodologies means that the development of a definitive Pillar 3 framework for these risks is likely to be an iterative

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Box 7.1

PROGRESS IN IMPLEMENTING THE BASEL PILLAR 3 FRAMEWORK: CONSULTATIVE DOCUMENTS ON BANKS' EXPOSURES TO CRYPTO-ASSETS AND CLIMATE-RELATED FINANCIAL RISKS (cont'd)

process. Moreover, the consultation notes that the Committee, based on the feedback received through this process, must decide which templates are mandatory and which subject to national discretion. The proposed implementation date for the framework is 2026, one year after the effective date proposed by the ISSB and after the expiration of the ISSB's transitional arrangements, which include financed emissions.

8

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

THE BANCO DE ESPAÑA'S REMIT

The Banco de España prepares circulars implementing higher-ranking regulations, and technical guidelines with criteria, practices, methodologies and procedures for compliance with supervisory regulations

NEW REGULATORY DEVELOPMENTS AT THE BANCO DE ESPAÑA

Since January 2023, the Banco de España has published three circulars on covered bonds, the Central Credit Register, and remuneration policy and conduct of activities without branches, as well as guidelines on governance and transparency of revolving credit

DRAFT CIRCULARS UNDER WAY AT THE BANCO DE ESPAÑA

Four circulars in the draft stage, two relating to reporting obligations to the Banco de España, one on institutions' conduct and another on the calculation method for institutions' contributions to the Deposit Guarantee Scheme.

OTHER NEW REGULATORY DEVELOPMENTS

Noteworthy developments at the European Union level include the publication of the Markets in Crypto-Assets Regulation, the amendment of the Capital Requirements Regulation and Directive, the new Directive on consumer credit and the European Commission's presentation of the digital finance package

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8.1 Banco de España Circulars and Guidelines

8.1.1 Circular 1/2023

Banco de España Circular 1/2023 of 24 February 2023 to credit institutions, branches in Spain of credit institutions authorised in another Member State of the European Union and specialised lending institutions (SLIs) on the information to be submitted to the Banco de España relating to covered bonds and other loan mobilisation instruments, and amending Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial reporting rules and formats and Circular 4/2019 of 26 November 2019 to specialised lending institutions on public and confidential financial reporting rules and formats.

The publication of Royal Decree-Law 24/2021 establishes, among other issues, the reporting obligations to the Banco de España of credit institutions that issue covered bonds. These obligations relate to the eligibility of assets and cover pool requirements, the cover pool liquidity buffer and any other information that the Banco de España deems necessary for the exercise of its supervisory functions over covered bonds. This Royal Decree-Law also sets out the requirements relating to collateralised mortgage bonds, mortgage transfer certificates and loan mobilisation instruments or loans secured by first chattel mortgage or first non-possessory pledge that may be issued by credit institutions and SLIs. These new obligations to report information to the Banco de España can be found in Banco de España Circular 1/2023 of 24 February 2023. Institutions began to submit this information with reference data from March 2023.

8.1.2 Circular 2/2023

Banco de España Circular 2/2023 of 17 March 2023 amending Circular 1/2013 of 24 May 2013 on the Central Credit Register.

This Circular includes significant changes to the information that institutions must submit, the most relevant of which are as follows:

— since January 2023 reporting institutions must submit to the Central Credit Register all individualised transactions with borrowers with a cumulative exposure of €3,000 or more (previously €6,000);

— information in some modules is now shown in a more simplified way;

— the accounting data for loans to natural persons are included as additional information, as has been the case since 2018 for legal entities;

— the borrower's annual disposable income is requested at the outset of household lending processes.

8.1.3 Circular 3/2023

Banco de España Circular 3/2023 of 31 October 2023, amending Circular 2/2016 of 2 February 2016 to credit institutions on supervision and solvency, completing the transposition into Spanish legislation of Directive 2013/36/EU and Regulation (EU) No 575/2013, and Circular 1/2022 of 24 January 2022 to specialised lending institutions on liquidity, prudential rules and reporting obligations.

The amendment of Circular 2/2016 prohibits third country credit institutions with no branch presence in Spain from receiving deposits in the course of operations. This ban was introduced in 2022 in an amendment to Law 10/2014 of 26 June, on the regulation, supervision and solvency of credit institutions. In addition, some valuation methods were incorporated in the process of authorising the provision of services without any branches.

The amendment of Circulars 2/2016 and 1/2022 updates the current supervisory reporting of remuneration for both credit institutions and SLIs, bringing it proportionately into line with the guidelines of the European Banking Authority (EBA) on the benchmarking exercises on remuneration practices, the gender pay gap and approved higher ratios under Directive 2013/36/EU (EBA/GL/2022/06), and the guidelines on the data collection exercise regarding high earners under Directive 2013/36/EU and Directive (EU) 2019/2034 (EBA/GL/2022/08). This amendment aligns supervisory reporting with the market disclosure regime (Pillar 3) and includes two newly created data collection templates: one for reporting the gender pay gap and another to harmonise the benchmarking of approvals granted by shareholders to use higher ratios between variable and fixed remuneration.

8.1.4 Circular 1/2024

Banco de España Circular 1/2024 of 26 January 2024 to banks, credit cooperatives and other supervised institutions in relation to information on the capital structure and amending Circular 1/2009 of 18 December 2009 to credit institutions and other supervised institutions in relation to information on the capital structure and non-voting equity units of credit institutions, and on their branches.

A circular on capital structure was published in February 2024 that comprehensively and fully regulates the new information on this matter, repealing the existing legislation contained in Chapter I of Circular 1/2009 of 18 December 2009, since, in recent years, amendments have been made to Spanish legislation that make it advisable to update and harmonise these requirements. In addition, the new Circular also repeals Chapter III of the aforementioned Circular 1/2009, relating to registration in the Senior Officer Register and the submission of information on other positions held by senior officers in other companies, since the rules contained in that chapter were obsolete and had been superseded by subsequent legislation of equal or higher rank. However, institutions still fall under the reporting obligations on this matter that derive from the legislation applicable to them.

The scope of application includes banks, credit cooperatives, SLIs, payment institutions and electronic money institutions.

8.1.5 *Guidelines on the governance and transparency of revolving credit for institutions subject to Banco de España supervision*

These guidelines contain the best market practices identified in the exercise of the Banco de España's supervisory function, along with the criteria and procedures that it deems suitable for ensuring compliance with the rules applicable to the design and arrangement of revolving credit,[1] to help supervised institutions comply with and implement them and encourage responsible practices in marketing this type of credit.

In preparing these guidelines, consideration was given both to the specific regulations for this type of product approved in 2020 and to the EBA's guidelines on "product oversight and governance arrangements for retail banking products",[1] "remuneration policies and practices related to the sale and provision of retail banking products and services"[2] and "loan origination and monitoring",[3] adopted by the Banco de España.

8.2 Other draft circulars in progress

A circular is being drafted to payment service providers on the information to be submitted to the Banco de España and other measures applicable to these providers.

The draft circular comes in response to the need to further develop some of the provisions of the regulations governing payment services, to ensure their appropriate implementation and their supervision by the Banco de España, as the authority tasked with guaranteeing and monitoring effective compliance. This requires providing details of some of the obligations set out therein and the relevant information to be available, particularly in relation to the following:

- outsourcing of functions by certain payment service providers;

1 EBA/GL/2015/18.
2 EBA/GL/2016/06.
3 EBA/GL/2020/06.

- reasonable grounds for suspecting fraud in unauthorised payment transactions;

- denial of access to a payment account by an account servicing payment service provider to a payment initiation service provider or an account information service provider;

- operational and security risks, and notification of major operational or security incidents;

- compliance with the standards for strong customer authentication and common and secure open standards of communication.

In addition, a review will be undertaken of Banco de España Circular 5/2016 of 27 May 2016 on the calculation method to be used to ensure that the contributions of institutions belonging to the Deposit Guarantee Scheme for Credit Institutions are proportionate to their risk profile, in order to enable implementation, by means of the appropriate regulatory amendments, of the Guidelines (revised) on methods for calculating contributions to deposit guarantee schemes (DGSs) under Directive 2014/49/EU, repealing and replacing Guidelines EBA/GL/2015/10 (EBA/GL/2023/02). These guidelines, published by the EBA on 21 February 2023 and adopted as their own by the Banco de España on 18 September 2023, aim to clarify and enhance the method for calculating institutions' contributions to DGSs to ensure that these contributions are better aligned with the risk profile, thus enabling the target level of the DGS fund to be met and maintained.

The review of Circular 5/2016 falls within the Banco de España's remit as the competent authority responsible for developing the calculation method for contributions to the DGS.

A circular is also being drafted on requirements and obligations relating to institutions' conduct, transparency of banking services and customer protection, repealing Banco de España Circular 5/2012.

This draft circular addresses the need to rationalise and update the regulations on conduct, banking transparency and customer protection currently set out in Banco de España Circular 5/2012 of 27 June 2012 to credit institutions and payment service providers on the transparency of banking services and responsible lending. Since this circular was approved, both the regulatory framework for the different banking products and services and the business models of supervised institutions have undergone major changes, mainly as a result of the headway made in new technologies and the gradual digitalisation of financial services, which warrant a comprehensive review of the regulatory developments contained in the circular and an assessment of whether it is fit for purpose.

8.3 Other new regulatory developments

Also worth mentioning is Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (the MiCA Regulation).

The MiCA Regulation was published in the Official Journal of the European Union on 9 June 2023. This regulation establishes a regulatory framework for crypto-asset activities and markets and introduces requirements on the issuance, offer to the public and admission to trading of crypto-assets, and on the provision of crypto-asset services. It also includes a specific arrangement for the supervision of these activities, as well as a sanctioning regime for all of them.

The MiCA Regulation defines crypto-assets as a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology (DLT) or similar technology. However, MiCA does not apply to all the crypto-assets that fall under this definition. It excludes from its scope, among other things, crypto-assets that qualify as financial instruments or other products that are already regulated in existing legislation on financial services, and crypto-assets that are unique and not fungible with other crypto-assets. The European Central Bank and national central banks of Member States, when acting in their capacity as monetary authorities, are also outside its scope. Lastly, MiCA is not applicable to crypto-asset services that are provided in a fully decentralised manner without any intermediary.

The MiCA Regulation classifies crypto-assets into three categories: asset-referenced tokens (ARTs), electronic money tokens (EMTs) and crypto-assets other than ARTs and EMTs that are not excluded from the regulation's scope.

For each of the above-mentioned categories, the MiCA Regulation contains certain requirements relating to their issuance, offer to the public and admission to trading, varying in scope depending on the category. These requirements include the need to draw up and publish a white paper, before issuance, setting out the main features of such issuance, the rights and obligations of the issuers vis-à-vis the holders, etc. (in some cases, authorisation from the competent authority will also be required). In addition, the regulation establishes rules and requirements for the operation, organisation and governance of issuers of crypto-assets and requirements for the protection of holders of crypto-assets.

The MiCA Regulation also regulates the provision of crypto-asset services, for which authorisation as a crypto-asset service provider must generally be obtained from the competent authority, subject to compliance with the established requirements. In the case of authorised institutions (credit institutions, central securities depositories, investment firms, market operators, electronic money institutions, management companies managing undertakings for collective investment in transferable securities and alternative investment fund managers), certain services may be provided without such authorisation.

Specifically, the MiCA Regulation covers the following crypto-asset services: custody and administration of crypto-assets on behalf of clients; operation of a trading platform for crypto-assets; exchange of crypto-assets for funds or other crypto-assets; execution of orders for crypto-assets on behalf of clients; placing of crypto-assets; reception and transmission of orders for crypto-assets on behalf of clients; providing advice on crypto-assets; portfolio management of crypto-assets; and transfer services for crypto-assets on behalf of clients.

The MiCA Regulation shall enter into force on 30 December 2024, except for the provisions regarding ARTs and EMTs, which shall apply from 30 June 2024.

The year also saw the adoption of Law 6/2023 of 17 March 2023 on securities markets and investment services. Pursuant to Article 251 (last paragraph) of this law, the Banco de España is entrusted with the supervision, inspection and sanctioning of non-compliance with the obligations under the MiCA Regulation of issuers of ARTs and EMTs.

Also noteworthy was the European Commission's launch of the digital finance package in June. This package contains the measures described in Box 8.1.

In addition, mention should be made of Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC (CCD2), referred to in Box 4.2. The new directive aims to strengthen consumer protection and remove any obstacles to the cross-border consumer credit market, to this end extending its scope of application to cover certain agreements that were excluded from the previous regulation with a view to further harmonising the framework. Other key aspects include the provision for creditors and consumer credit intermediaries to be subject to an admission and registration process, and to supervision, in the Member States, and the duty of Member States to introduce measures to ensure that consumers do not bear excessively high borrowing rates, annual percentage rates or total costs of credit.

Lastly, in the area of prudential banking regulations, the Committee of Permanent Representatives of the Governments of the Member States to the European Union (Coreper) and the European Parliament's Committee on Economic and Monetary Affairs (ECON) approved the amendments to Regulation (EU) No 575/2013 (CRR-III) and Directive 2013/36 (CRD-VI). The primary objective of these regulations, in particular the CRR, is to translate the latest amendments to the Basel framework into European legislation (see Box 8.2).

Box 8.1

MODERNISING PAYMENT SERVICES AND OPENING FINANCIAL SERVICES DATA: THE LEGISLATIVE PROPOSALS OF THE EUROPEAN COMMISSION

The European Commission put forward three legislative proposals in June 2023 relating to payment services and data sharing in financial services. They are as follows:

a) a draft regulation for payment services in the internal market (Payment Services Regulation, PSR);

b) a draft directive on payment and electronic money services in the internal market (PSD3), repealing Directive 2015/2366 (known as PSD2) and the E-Money Directive;

c) a legislative proposal for a regulation on a framework for financial data access (FiDA).

According to the European Commission, these proposals are intended to improve consumer protection and competition in electronic payments, as well as empower consumers to securely share their data so that they can better access financial products and services.

PSR and PSD3 represent an evolution of PSD2, intended to:

a) harmonise arrangements for payment services and electronic money;

b) combat fraud by enabling payment service providers to share information among themselves, strengthening customer authentication, extending refund rights of consumers who fall victim to fraud and checking alignment of payees' IBAN numbers with their names in credit transfers;

c) improve consumer rights, making more information available to them;

d) harmonise regulations for banks and non-banking institutions, allowing the latter access to payment systems and securing their rights to a bank account;

e) improve the functioning of open banking; and

f) improve the availability of cash in shops and via automated teller machines.

FiDA establishes a framework of rights and obligations for sharing data on loans, savings, investments, pensions and insurance (excluding life insurance) for financial service customers, including the following:

a) Customers have the right to access their data held by financial institutions and share them with other financial institutions, including new financial information services providers.

b) Financial institutions must make customer data – subject to prior customer permission – available to other institutions via technical infrastructure. To do so, the proposal aims to encourage financial institutions to put in place technical interfaces and to standardise customer data and technical interfaces as part of creating financial data sharing schemes, in which both data holders and data users become members.

Box 8.2

FINAL PHASE OF BASEL III IMPLEMENTATION IN THE EUROPEAN UNION

The Committee of Permanent Representatives of the Governments of the Member States to the European Union (Coreper) and the European Parliament's Committee on Economic and Monetary Affairs (ECON) have approved the amendments to Regulation (EU) No 575/2013 (CRR-III) and Directive 2013/36 (CRD-VI).[1]

The main aim of this reform was the implementation in the EU of the final amendments to the Basel capital framework (Basel III), with two distinct documents:

— Amendment of Regulation (EU) No 575/2013 (CRR-III). This is the fundamental part of the reform, including changes to the calculation methods for own funds requirements.

— Amendment of Directive 2013/36 (CRD-VI). While this incorporates changes relating to implementation of Basel III, its fundamental purpose is to enhance the way institutions address environmental, social and governance (ESG) risks, as well as enhance the supervisory framework for institutions and harmonisation of divergent national laws.

CRR-III will enter into force on 1 January 2025. Turning to CRD-VI, Member States will have 18 months from its publication to transpose it into national legislation. In December 2023 the European Banking Authority (EBA) published a roadmap[2] on strengthening the prudential framework, ensuring an international level playing field and providing the industry with clarity on how the EBA will develop the mandates to implement the legislation and how it expects to finalise the most significant components prior to the application date. All of the above will facilitate banks' implementation of the package.

I Main changes introduced by CRR-III

One of the aims of Basel III[3] is to mitigate the variability and lack of comparability of banks' risk-weighted assets (RWAs) entailed by the use of internal models. To this end, a series of measures is introduced that CRR-III incorporates into EU legislation. The adoption of Basel III in the EU is, broadly speaking, complete and consistent with the international framework, although it introduces some European specificities not covered by the Basel framework.

The most significant changes introduced in CRR-III for the EU-wide implementation of Basel III are as follows.

— Output floor: it sets a lower limit for overall RWAs for any bank at 72.5% of RWAs calculated using the standardised approach. In the EU, the output floor will apply at all levels of consolidation, although each Member State may derogate from the individual or subconsolidated level for banking group entities within its jurisdiction. Certain transitional arrangements have also been introduced (in addition to those set out in Basel III) to phase in the framework, so that the output floor will only be fully applicable by 2032.

— Credit risk: the new regulation enhances granularity and sensitivity to certain classes of exposure in the standardised approach (e.g. retail or equity exposures). Internal models are no longer permitted for certain exposures (equity), the advanced internal ratings-based (A-IRB) approach is no longer an option for other exposures (financial institutions and large corporates) and new restrictions are placed on institutions' estimates of parameters. In addition, various transitional arrangements have been agreed in the EU that go beyond Basel III so that banks can gradually adapt to the new rules, e.g. the application of valuation haircuts on leased assets.

— Operational risk: as set out in the Basel framework, internal models may no longer be used in the EU to calculate own funds requirements for this type of risk, but legislators exercised the option provided in Basel III to disregard historical losses when calculating requirements. As such, capital needs will be determined solely by the "business indicator component", which measures an institution's volume of business. At this point, it should also be noted that CRR-III goes further than Basel III to introduce the possibility of the supervisor allowing a bank to calculate the interest component (which is part of the business indicator) separately for each subsidiary in a group, under certain conditions.

1 On 6 December 2023 in Coreper and 11 December 2023 in ECON.

2 *EBA Roadmap on strengthening the prudential framework.*

3 Finalising Basel III. In brief.

Box 8.2

FINAL PHASE OF BASEL III IMPLEMENTATION IN THE EUROPEAN UNION (cont'd)

— Market risk: Basel III's new market risk calculation approaches are introduced (the alternative internal model approach, the alternative standardised approach and the standardised approach), but the European Commission is empowered to adopt a delegated act to modify the framework or postpone its application if differences are observed between the EU's adoption of international standards and that of third countries.

— Credit valuation adjustment (CVA) risk: internal calculation models are eliminated and new calculation methods based on Basel III are introduced (standard, basic and simplified alternative – the latter on the basis of proportionality).

With regard to the impact of the reforms, a recent EBA study, carried out in September 2023, assessed the burden the new regulation would place on EU banks, showing that, in general, European banks' minimum Tier 1 capital requirements would rise by 9.0%. This impact would be around 12.6% if the European specificities other than the Basel III's allowed options were not considered, although most of this discrepancy is the result of particularities that already exist in the current version of the regulation, such as the SME supporting factor or EU exclusions from CVA calculations.

Lastly, bearing no relation to the adoption of Basel III, CRR-III introduces transitional arrangements for the prudential treatment of banks' exposures to crypto-assets, which will remain in force until the Commission delivers its legislative proposal (to be published by 30 June 2025 at the latest), implementing at EU level the framework agreed by the Basel Committee. CRR-III also regulates the information that institutions must disclose about their crypto-asset exposures.

II Main amendments brought about by CRD-VI

The amendments introduced by CRD-IV have two key objectives. First, to strengthen the treatment of ESG risks and, second, to harmonise supervisory powers within the EU.

The banking package seeks, among other things, to strengthen the focus on ESG risks in the prudential framework with a view to addressing the possible impacts of climate change and other ESG risks on credit institutions. New developments notably include the inclusion of ESG risks in the supervisory review process (SREP) and the possibility of using the systemic risk buffer to address climate-related risks. In addition, CRR-III extends the application of ESG disclosure requirements to all credit institutions, taking into account the principle of proportionality, and introduces new requirements for reporting ESG risks to the supervisor.

Finally, regarding the harmonisation of supervisory powers, three aspects should be noted.

a) Third-country branches: the current regime applied to these branches is subject to national legislation and is highly divergent. CRD-VI, first of all, establishes the obligation for foreign banks wishing to engage in deposit-taking or lending activities in a Member State to request authorisation to set up a branch. Moreover, it establishes minimum capital and liquidity requirements for these branches and recognises the minimum supervisory powers that competent authorities should have, including the power to require the transformation of a branch into a subsidiary, in certain circumstances.

b) Additional harmonisation of the fit and proper framework: "large" institutions (assets exceeding €30 billion) must request a "suitability assessment" from their supervisor when planning to appoint a new member to the management body. This is so that the supervisor, in the event of doubt regarding the suitability of the proposed candidate, may engage in an "enhanced dialogue" with the institution to address these concerns and ensure that the candidate meets the suitability requirements when they take up the position.

c) New supervisory powers: institutions must notify the supervisor of any acquisition or sale of investments in any type of entity when the amount thereof exceeds 15% of the acquiring entity's total assets. Following assessment of the transaction, the supervisor may decide to oppose it. In addition, the supervisors must approve all mergers and divisions of entities.

4 The full EBA report can be found here.


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INTERNAL AUDIT REPORT

REPORT PROVIDED FOR IN LAW 10/2014 OF 26 JUNE 2014 ON THE REGULATION, SUPERVISION AND SOLVENCY OF CREDIT INSTITUTIONS

1. Introduction

Article 55 bis of Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions (LOSS)[1] establishes that "the Banco de España shall prepare an annual report on its supervisory function, describing the supervisory actions undertaken and procedures followed, permitting information to be gained on the effectiveness and efficiency of these procedures and actions". It also provides that such annual report shall include a report by the internal control body on the conformity of the decisions taken by the governing bodies of the Banco de España with the procedural regulations applicable in each case. This annual report shall be approved by the Governing Council of the Banco de España and sent to the Spanish Parliament and Government.

The Banco de España's 2023 Annual Internal Audit Plan includes the drafting of the report provided for in the above-mentioned LOSS, so that it may be included in the Banco de España's Annual Report on its supervisory function, referred to above.

2. Purpose, scope and methodology of the report

This report falls within the bounds of the legal mandate contained in Article 55 bis 2 of the LOSS, which, as indicated above, defines the scope of the report, by reference to three basic elements:

1) The supervisory function of the Banco de España.

2) The decisions taken by the governing bodies in exercise of the supervisory function.

3) The conformity of the foregoing decisions with the procedural regulations applicable.

As regards the reporting period, the report refers to the decisions taken by the Executive Commission in 2023, or submitted to the Governing Council for approval, and the decisions adopted by delegation and notified to the Executive Commission in 2023. The subject matter of the report relates to the decisions taken, in the exercise of the supervisory function, by the Banco de España's governing bodies within the spheres of competence of the Directorate General Banking Supervision; the Directorate General Financial Stability, Regulation and Resolution; the Directorate General Operations, Markets and Payment Systems; the Directorate General Financial Conduct and Banknotes; and the General Secretariat.

Regarding applicable regulations, the supervisory powers and procedures set out in Law 13/1994 of 1 June 1994 on the Autonomy of the Banco de España and in the Internal Rules of the Banco de España were taken into account, together with those established by the Single Supervisory Mechanism regulations, primarily Council Regulation (EU) No 1024/2013 of 15 October 2013 and Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014.

On 2 November 2012, procedural rules were laid down on the reporting of matters to the Executive Commission applicable to all the Banco de España's Directorates General. These rules are complemented by other specific rules of certain Directorates General which were also approved by the Executive Commission of the Banco de España.

Likewise, by means of a Resolution of 10 December 2019, the Executive Commission approved the regime governing the delegation of powers, published in the Official State

[1] With regard to the supervisory report on its actions and procedures, the obligation is provided for in the LOSS due to the double amendment introduced by Law 6/2023 of 17 March 2023 on Securities Markets and Investment Services. Until the previous supervisory report, the obligation of the Banco de España was set out in the Securities Market Law, consolidated by Royal Legislative Decree 4/2015 of 23 October 2015.

Gazette No. 311 of 27 December 2019,[2] and which provides for the delegation of signature and callback of delegated powers.

To review the decisions adopted by the Executive Commission and the decisions adopted by delegation, random sampling was performed by Directorate General.[3]

The work was conducted in accordance with the Internal Audit Manual, which includes the International Standards for the Professional Practice of Internal Auditing, approved by the Institute of Internal Auditors, including those relating to the Code of Ethics.

3. Opinion

In our opinion, the decisions adopted by the governing bodies of the Banco de España in 2023, in the exercise of its supervisory function, were taken by bodies with sufficient own or delegated powers in accordance with the Internal Rules of the Banco de España and with the provisions laid down by its Executive Commission, and conformed, in all material respects, with the applicable procedural rules existing in each case.

Madrid, 5 March 2024

Director of the Internal Audit Department

Luis E. Pardo Merino

GOVERNOR OF THE BANCO DE ESPAÑA

DEPUTY GOVERNOR OF THE BANCO DE ESPAÑA

[2] In force since 28 December 2019. The Resolution of 10 December 2019 was subsequently amended by the agreements of 8 September 2020 (Official State Gazette No. 243 of 11 September 2020), 27 July 2021 (Official State Gazette No. 180 of 29 July 2021), 3 May 2022 (Official State Gazette No. 107 of 5 May 2022) and 8 November 2023 (Official State Gazette No. 275 of 17 November 2023) of the Executive Commission of the Banco de España.

[3] The random sampling was performed by establishing two groups for each Directorate General: one for resolutions adopted directly by the Executive Commission and another for decisions adopted by delegation of powers. Also, other decisions have been included in the sampling when, based on an audit criterion, they would be deemed appropriate to obtain an adequate opinion.

INDEX OF PHOTOGRAPHS

BANCO DE ESPAÑA PUBLICATIONS

The Banco de España publishes various types of documents providing information on its activity (economic reports, statistics, research papers, etc.), which can be found in the Institutional Repository, at https://repositorio.bde.es/?locale=en.

Most of these documents are available in PDF format and can be downloaded free of charge from the Banco de España website at https://www.bde.es/wbe/en/publicaciones/.

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ACRONYMS AND ABBREVIATIONS

AMCESFI	Spanish Macroprudential Authority
AML/CFT	Anti-money laundering and countering the financing of terrorism
AMLA	Anti-Money Laundering and Countering the Financing of Terrorism Authority
APP	Asset Purchase Programme
APR	Annual percentage rate
ART	Asset-Referenced Tokens
AT1	Additional Tier 1 Capital
BCBS	Basel Committee on Banking Supervision
BigTech	Major globally active firms with a relative advantage in digital technology
BIS	Bank for International Settlements
BMEC	BME Clearing
CC	Central Counterparty
CCD2	Consumer Credit Directive 2
CCyB	Countercyclical capital buffer
CET1	Common Equity Tier 1 Capital
CGP	Code of good practice
CIR	Central Credit Register
CIRBE	Banco de España's Central Credit Register
CNMV	Spanish National Securities Market Commission
CPBCIM	Commission for the Prevention of Money Laundering and Monetary Offences
CPMI	Committee on Payments and Market Infrastructures
CRD	Capital Requirements Directive
CRD-VI	Capital Requirements Directive VI
CRR	Capital Requirements Regulation
CRR-III	Capital Requirements Regulation III
CSD	Customer services department
CSDR	Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositaries
CSRBB	Credit spread risk arising from their non-trading book activities
DCV	Central Securities Depositaries
DG.EFR	Directorate General Financial Stability, Regulation and Resolution
DG.OMP	Directorate General Operations, Markets and Payment Systems
DG.SUP	Directorate General Banking Supervision
DGSFP	Directorate General of Insurance and Pension Funds *(Dirección General de Seguros y Fondos de Pensiones)*
DORA	Digital Operational Resilience Act
DRC	Debt recovery costs
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
ELMI	Electronic money institutions
EMT	Electronic money tokens
EPC	European Payments Council
ESA	European Supervisory Authorities
ESG	Environmental, social and governance
ESI	European Standardised Information
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EURO1	Large-value payments system
FIDA	Proposal for Regulation on Financial Data Access
FinCoNet	International Financial Consumer Protection Organisation
FinTech	Financial technology
FIU	Financial Intelligence Units
FLESB	Forward Looking Exercise on Spanish Banks
FSB	Financial Stability Board
FSC	Financial Stability Committee
FSTC	Financial Stability Technical Committee
GDP	Gross domestic product
G-SII	Global systemically important institution
Iberpay	Sociedad Española de Sistemas de Pago, SA
ICAAP	Internal capital adequacy assessment process
ICO	Official Credit Institute *(Instituto de Crédito Oficial)*
IFRS9	International Financial Reporting Standard 9 on Financial Instruments
ILAAP	Internal liquidity adequacy assessment process
IMF	Internacional Monetary Fund
IMI	Internal model investigations
IOSCO	International Organization of Securities Commissions
IPREM	Public Indicator of Income for Multiple Purposes
IRB	Internal rating-based models
IRRBB	Interest rate risk in the banking book
ISSB	International Sustainability Standards Board
IT	Information technologies
ITS	Implementing technical standards
JST	Joint Supervisory Team
LCR	Liquidity coverage ratio
LGD	Loss given default
LMVSI	Securities Markets and Investment Services Law
LSI	Less significant institutions
LTV	Loan-to-value
MGS	Mutual guarantee society
MiCA	Markets in Crypto-Assets
ML	Machine learning
ML/FT	Money laundering and the financing of terrorism
MMF	Money Market Funds
NBFI	Non-Banking Financial Intermediation
NCA	National competent authority
NGFS	Network for Greening the Financial System
O-SII	Other systemically important institution
P2G	Pillar 2 guidance
P2R	Pillar 2 requirements
PD	Probability of default
PEPP	Pandemic Emergency Purchase Programme
PI	Payment institution
PISA	Payment Instruments, Schemes and Arrangements
PSD2	Payment Services Directive 2
PSD3	Payment Services Directive 3
PSR	Payment Services Regulation
RegTech	Regulatory technology
RoE	Return on Equity
RT1	Real time payment system
RTS	Regulatory technical standards
RWA	Risk-weighted assets
Sareb	Asset management company for assets arising from bank restructuring *(Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria)*
SCA	Strong customer authentication
SEPA	Single Euro Payments Area
SEPBLAC	Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences
SG.GRL	General Secretariat of the Banco de España
SI	Significant institution
SIPS	Systemically important payment systems
SLI	Specialised lending institution
SNCE	National Electronic Clearing System (Sistema Nacional de Compensación Electrónica)
SREP	Supervisory review and examination process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
STEP2	Retail payment system
STMP	Sistema de Tarjetas y Medios de Pago
STS	Simple, Transparent and Standardised
SupTech	Supervisory technology
T2	Tier 2 capital
TARGET2	Trans-European Automated Real-time Gross Settlement Express Transfer System
TLTRO III	Targeted Longer-Term Refinancing Operations III
—	
bn	Billion
€m	Millions of euros
bp	Basis points
pp	Percentage points